OMB EFFORTS TO REPEAL THE RULE OF TWO

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SBA AND SBIC AUTHORITY,
MINORITY ENTERPRISE AND GENERAL
SMALL BUSINESS PROBLEMS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

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OMB EFFORTS TO REPEAL THE RULE OF TWO

THURSDAY, JUNE 5, 1986

House of Representatives, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, Committee on Small Business,

Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2359-A, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

Mr. Mitchell. Good morning.

The hearing will now come to order.

We face a very unusual situation in that the House of Representatives is working on the Housing bill at this time, and it means that there will be frequent votes and, therefore, frequent interruptions. I would urge that the members who are in attendance when we have a vote would go make their vote and come right back.

At present, there is a quorum vote, which I will not make, but that will be our problem, and I will ask the witnesses to bear with us under this rather difficult situation.

This hearing obviously should not be necessary. It should be unnecessary to remind someone within the administration of the critical role small business plays in the economy.

Obviously, we are constantly fighting to get small business to share in the Federal acquisition system. From both a social and economic standpoint, it is dangerous to have 80 percent of our Federal purchase budget concentrated in the hands of less than 1 percent of the business establishments that are defined as big businesses. That is dangerous.

It should be unnecessary, but, unfortunately, the Office of Management and Budget has made this hearing necessary this morning. On May 22, 1986, OMB published in the Federal Register its peculiar interpretation of a provision of the Competition in Contracting Act that it claims requires repeal of the so-called "Rule of Two." OMB's action was preceded, and I want to emphasize this, it was preceded by a flat refusal of the three procurement regulatory agencies, the Department of Defense, NASA, and GSA, to promulgate this convoluted statutory interpretation when they were directed to do so by the Office of Federal Procurement Policy. Consequently, we have a situation where OMB has situated itself as the lone, single interpreter of procurement law in the executive branch. It has also taken to writing procurement regulations for all the buying agencies, whenever it wishes to further its own peculiar point of view.

It is not in my opening statement, but one of the marvelous things about our system that has always impressed me has been the balances and checks. But, when we let the kind of situation we have at OMB remain, it seems to me we begin to erode that system of balances and checks.

Finally, we note OMB's avoidance of the provisions of the Regulatory Flexibility Act in order to expedite its design to repeal the Rule of Two.

Obviously, we have some problems. There is a problem with set-asides and, unfortunately, the Congress has failed to act on that.

However, the one effective solution to that problem is the reform of size standards so that in those affected industries, the Rule of Two does not trigger a set-aside determination for nearly every acquisition need.

The solution is not, is not in abandoning the Rule of Two, which is a tried and true test of competition, and substituting for it an arbitrary and unworkable standard that will simply destroy set-asides.

It seems to me there are five issues involved in this hearing.

One, did OMB improperly interpret the Competition in Contracting Act and/or did it abuse its authority under the office of Federal Procurement Policy Act?

Two, did OMB violate the Regulatory Flexibility Act by certifying that the repeal of the Rule of Two would not have a significant impact on a substantial number of small businesses?

Three, from an acquisition policy standpoint, can OMB's May 22, 1986 directive be effectively implemented by acquisition personnel?

Four, what would be the effect on the small business share of the prime contract dollar if the Rule of Two were eliminated?

And, finally, No. 5, were there any extraneous matters unrelated to the merits of the situation which motivated OMB to act in the manner it did?

It is my hope that the witnesses here today will provide us answers to these questions. Originally, because of the seriousness of this situation, I had planned to place all of the witnesses under oath. In light of some subsequent developments, I will not do that this morning.

[Mr. Mitchell's opening statement, information paper on Rule of Two, and other related materials follow:]

Opening Statement of Chairman Mitchell

THIS HEARING SHOULD BE UNNECESSARY. IT SHOULD BE UNNECESSARY TO REMIND SOME WITHIN THE ADMINISTRATION OF THE CRITICAL ROLE SMALL BUSINESS PLAYS IN THE ECONOMY. IT SHOULD BE UNNECESSARY TO DEFEND CONSTANTLY THE PREMISE THAT MORE SMALL BUSINESS PARTICIPATION IN THE FEDERAL ACQUISITION SYSTEM MEANS MORE COMPETITION AND LOWER PRICES. IT SHOULD BE UNNECESSARY TO STRESS, TIME AND TIME AGAIN, THAT IT IS DANGEROUS BOTH FROM A SOCIAL AND ECONOMIC STANDPOINT TO HAVE OVER 80 PERCENT OF OUR FEDERAL PURCHASE BUDGET CONCENTRATED IN THE HANDS OF LESS THAN 1 PERCENT OF THE BUSINESS ESTABLISHMENTS THAT ARE DEFINED AS "BIG BUSINESS." IT SHOULD BE UNNECESSARY, BUT UNFORTUNATELY, THE OFFICE OF MANAGEMENT AND BUDGET HAS PROVEN IT IS NOT.

ON MAY 22, 1986, OMB PUBLISHED IN THE FEDERAL REGISTER ITS UNIQUELY PECULIAR INTERPRETATION OF A PROVISION OF THE COMPETITION IN CONTRACTING ACT (CICA) THAT IT CLAIMS REQUIRES REPEAL OF THE SO-CALLED "RULE OF TWO". OMB'S ACTION WAS PRECEDED BY A FLAT REFUSAL OF THE THREE PROCUREMENT REGULATORY AGENCIES -- DOD, NASA, AND GSA -- TO PROMULGATE THIS CONVOLUTED STATUTORY INTERPRETATION WHEN THEY WERE DIRECTED TO DO SO BY THE OFFICE OF FEDERAL PROCUREMENT POLICY (OFPP). CONSEQUENTLY, NOT ONLY DO WE HAVE A SITUATION WHERE OMB HAS SITUATED ITSELF AS THE LONE INTERPRETER OF PROCUREMENT LAW IN THE EXECUTIVE BRANCH, BUT IT HAS ALSO TAKEN TO WRITING PROCUREMENT REGULATIONS FOR ALL BUYING AGENCIES WHENEVER IT WISHES TO FURTHER ITS OWN PECULIAR VIEWPOINT. ACCORDINGLY, ASIDE FROM THE VALIDITY OF OMB'S INTERPRETATION WE SHALL EXPLORE WHETHER OMB HAS ABUSED ITS AUTHORITY UNDER THE OFFICE OF FEDERAL PROCUREMENT POLICY ACT BY ASSERTING A RIGHT TO

PROMULGATE PROCUREMENT REGULATIONS WHEN THERE IS NO DISAGREEMENT AMONG THE THREE REGULATORY AGENCIES. FINALLY, WE NOTE OMB'S AVOIDANCE OF THE PROVISIONS OF THE REGULATORY FLEXIBILITY ACT (RFA) IN ORDER TO EXPEDITE ITS DESIGN TO REPEAL THE "RULE OF TWO". NEEDLESS TO SAY, WE ARE DEEPLY DISMAYED, NOT ONLY ABOUT THE PROPRIETY OF OMB'S ACTION, BUT WE ARE ALSO CONCERNED ABOUT THE EXAMPLE IT HAS SET FOR EVERY OTHER AGENCY OF GOVERNMENT TO FOLLOW WITH RESPECT TO THEIR RESPONSIBILITIES UNDER THE RFA.

I DO NOT MEAN TO INDICATE BY THESE HEARINGS THAT THERE ARE NO PROBLEMS WITH SMALL BUSINESS SET-ASIDES. AS I HAVE STATED ON MANY OCCASIONS, OVERLY "GENEROUS" SIZE STANDARDS IN CERTAIN INDUSTRIES HAVE RESULTED IN ECONOMIC CONCENTRATION IN THOSE AREAS AND HAVE PROVIDED A DISINCENTIVE FOR CAPITAL INVESTMENT AND GROWTH. HOWEVER, THE ONE EFFECTIVE SOLUTION TO THAT PROBLEM IS THE REFORM OF SIZE STANDARDS SO THAT, IN THOSE INDUSTRIES, THE "RULE OF TWO" DOES NOT TRIGGER A SET-ASIDE DETERMINATION FOR NEARLY EVERY ACQUISITION NEED. THE SOLUTION IS NOT ABANDONING THE "RULE OF TWO", WHICH IS A TRIED AND TRUE TEST OF COMPETITION, AND SUBSTITUTING FOR IT AN ARBITRARY AND UNWORKABLE STANDARD THAT WILL EFFECTIVELY DESTROY THE PROGRAM.

IT IS INDEED UNFORTUNATE THAT A NARROW MAJORITY OF THIS COMMITTEE REFUSED TO APPROVE LEGISLATION THAT WOULD HAVE REFORMED THE SIZE STANDARD SYSTEM AT SBA. IF WE HAD ACTED THEN PERHAPS WE WOULD NOT BE HERE TODAY TO FEND FOR THE VERY EXISTENCE OF THE SET-ASIDE PROGRAM. IT IS NOT SURPRISING TO ME THAT OUR FAILURE TO CORRECT THE SIZE STANDARDS PROBLEM HAS RESULTED IN POLITICAL PRESSURE TO ELIMINATE SET-ASIDES ALTOGETHER. THIS WAS THE CONTINGENCY THAT I ATTEMPTED TO AVOID WITH H.R. 1178. HOWEVER, I MUST HASTEN TO ADD THAT THE FIERCE AND PERHAPS ILLEGAL LOBBYING BY SBA AGAINST

THE BILL DID RESULT IN THE DISSEMINATION OF FALSE INFORMATION THAT MAY HAVE MOTIVATED MANY OF THE NEGATIVE VOTES IN THE FULL COMMITTEE.

NEVERTHELESS, THE SUBJECT TODAY IS NOT HOW WE MAY IMPROVE THE SET-ASIDE PROGRAM. THE ISSUES ARE, HOWEVER, FIVE-FOLD: (1) DID OMB IMPROPERLY INTERPRET THE COMPETITION IN CONTRACTING ACT AND/OR ABUSE ITS AUTHORITY UNDER THE OFFICE OF FEDERAL PROCUREMENT POLICY ACT? (2) DID OMB VIOLATE THE REGULATORY FLEXIBILITY ACT BY CERTIFYING THAT REPEAL OF THE "RULE OF TWO" WOULD NOT HAVE A SIGNIFICANT IMPACT ON A SUBSTANTIAL NUMBER OF SMALL ENTITIES? (3) FROM AN ACQUISITION POLICY STANDPOINT, CAN OMB'S MAY 22, 1986 DIRECTIVE BE EFFECTIVELY IMPLEMENTED BY ACQUISITION PERSONNEL? (4) WHAT WOULD BE THE EFFECT ON THE SMALL BUSINESS SHARE OF THE PRIME CONTRACT DOLLAR IF THE "RULE OF TWO" WERE ELIMINATED? AND (5) WERE THERE ANY EXTRANEOUS MATTERS UNRELATED TO THE MERITS OF THE SITUATION WHICH MOTIVATED OMB TO ACT IN THE MANNER IT DID?

IT IS MY HOPE THAT OUR WITNESSES WILL PROVIDE US ANSWERS TO THESE QUESTIONS. BECAUSE OF THE SERIOUSNESS OF THE MATTER UNDER CONSIDERATION, IT IS MY INTENT TO PLACE ALL OF OUR GOVERNMENT WITNESSES UNDER OATH.

Information Paper on Rule of Two

Definition: Contracting Officer is to set aside contract whenever there is a reasonable expectation that, (1) offers will be received from at least two responsible small business concerns; and, (2) awards will be made at reasonable prices.

When Adopted: The rule of two was first used by the Navy in 1964, by the entire military in 1978, by NASA in 1982, and by all agencies since 1984.

Set Aside Awards: In FY 1984, set asides were valued at $15.6 billion and represented nearly one-half of all prime contract awards to small business.

The Problem: Memo dated February 21, 1986, from the Administrator of the Office of Federal Procurement Policy (which is part of OMB) required that the Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA) publish for a 30 day comment period a proposed regulation that would be applicable to all military and civilian agencies. The regulation would: (1) repeal the rule of two; (2) prohibit a regular small business set aside unless the contracting officer determines before the contract is advertised that he/she will receive the lowest reasonable cost from a small business. In effect, any large business expressing a desire to compete for the award would preclude a set aside; (3) prohibit a class set-aside (i.e. for a class of items or services) unless the contracting officer provides a written determination that for each item being purchased small business will provide the lowest costs; and (4) prohibit a repetitive set aside unless the contracting officer provides a written determination reaffirming that small business will submit the lowest cost. Under existing regulations once an item is purchased under a set aside future purchases must also be set aside unless two or more small businesses are not expected to compete.

DoD, NASA, and GSA have all refused to publish the OFPP memorandum because of their belief that the new Competition In Contracting Act does not require repeal of the rule of two. OMB has, however, published the repeal on May 22 under a legal authority allowing them to publish procurement regulations when DoD, NASA, and GSA do not act in a "timely" manner.

Effect: The proposed regulation, if adopted, would likely destroy the set aside program. Small businesses will lose billions of dollars a year if the regulation should become effective.

Political Problems: It must be kept in mind that the move to "kill" set asides was started by those industries adversely affected by high size standards. Since H.R. 1178 has been defeated, the considerable support we had for the bill will now likely advocate for the adoption of the new regulation. Since set asides cannot be "fixed" by reforming size standards, we can expect these individuals and organizations to attack the very concept of set asides.

WHY OMB's INTERPRETATION OF THE COMPETITION IN CONTRACTING ACT (CICA) IS INCORRECT

Section 2733 of the Competition in Contracting Act (CICA) amended 41 U.S.C. sec 414 (1) to read as follows:

"To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies, and regulations, and good business practices --

> (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

OMB believes that the above quoted provision is inconsistent with the "rule of two". For the following reasons OMB is obviously incorrect:

(1) This section is a direction to the head of each executive agency, not to the three regulatory agencies that write the FAR;

(2) Since it is a direction to the head of each Federal agency, and not to the three (3) regulatory agencies, the requirement to establish "policies, procedures, and practices" which insure the receipt of a "sufficient number" of proposals pertains only to internal policies, procedures, and practices and not to the FAR;

(3) Internal policies, procedures, and practices that would unnecessarily restrict the number of otherwise eligible sources that could compete for an award may, in particular circumstances, include, for example, bonding requirements, restrictive specifications, geographic limitations, directed subcontracting sources, and other definitive elements of responsibility not reasonable in the light of the legitimate need of the buying agency;

(4) By law, under a small business set-aside, all responsible small business are eligible to submit an offer;

(5) The "rule of two" has nothing to do with limiting the number of eligible sources. The rule is applied prospectively (before the requirement is synopsized) by a contracting officer to determine whether a procurement should be set-aside -- not whether an eligible small business should be precluded from submitting an offer; and

(6) The OMB interpretation virtually destroys the intended effect of the set-aside program and it is not reasonable to assume, absent specific statutory language, that Congress intended to do that. In those relatively few instances when the contracting officer can

demonstrate that only small business will submit proposals and, therefore, that the OMB "lowest reasonable cost" test will be satisfied, are not set-asides rendered meaningless since the awards will be made to small business regardless of the procurement strategy used? Is it reasonable for OMB to assume that Congress intended to render the set-aside authority a practical nullity through the strained construction of a statutory provision that does not even mention set-asides?

WHY OMB MAY HAVE VIOLATED THE REGULATORY FLEXIBILITY ACT (P.L. 96-354)

The Regulatory Flexibility Act requires that an agency publish an "initial regulatory flexibility analysis" (5 U.S.C. sec. 603) whenever it is required to publish a notice of proposed rulemaking. An exception to this requirement can only be had "if the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities" (5 U.S.C. sec. 605(b)). The OFPP Acting Administrator made such a certification with respect to the May 22, 1986 Federal Register publication. The SBA Chief Counsel for Advocacy is responsible for monitoring compliance with the statute (5 U.S.C. sec. 612). Attached are relevant sections of the Act.

"§ 603. Initial regulatory flexibility analysis

The Requirement For an Analysis.

"(a) Whenever an agency is required by section 553 of this title, or any other law, to publish general notice of proposed rulemaking for any proposed rule, the agency shall prepare and make available for public comment an initial regulatory flexibility analysis. Such analysis shall describe the impact of the proposed rule on small entities. The initial regulatory flexibility analysis or a summary shall be published in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule. The agency shall transmit a copy of the initial regulatory flexibility analysis to the Chief Counsel for Advocacy of the Small Business Administration.

Content of the Analsis

"(b) Each initial regulatory flexibility analysis required under this section shall contain—

"(1) a description of the reasons why action by the agency is being considered;

"(2) a succinct statement of the objectives of, and legal basis for, the proposed rule;

"(3) a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply;

"(4) a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record;

"(5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the proposed rule.

"(c) Each initial regulatory flexibility analysis shall also contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. Consistent with the stated objectives of applicable statutes, the analysis shall discuss significant alternatives such as—

"(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;

"(2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities;

"(3) the use of performance rather than design standards; and

"(4) an exemption from coverage of the rule, or any part thereof, for such small entities.

"§ 605. Avoidance of duplicative or unnecessary analyses

"(a) Any Federal agency may perform the analyses required by sections 602, 603, and 604 of this title in conjunction with or as a part of any other agenda or analysis required by any other law if such other analysis satisfies the provisions of such sections.

Exception From Analysis

"(b) Sections 603 and 604 of this title shall not apply to any proposed or final rule if the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. If the head of the agency makes a certification under the preceding sentence, the agency shall publish such certification in the Federal Register, at the time of publication of general notice of proposed rulemaking for the rule or at the time of publication of the final rule, along with a succinct statement explaining the reasons for such certification, and provide such certification and statement to the Chief Counsel for Advocacy of the Small Business Administration.

"(c) In order to avoid duplicative action, an agency may consider a series of closely related rules as one rule for the purposes of sections 602, 603, 604 and 610 of this title.

"§ 612. Reports and intervention rights

Chief Counsel's Responsibility

"(a) The Chief Counsel for Advocacy of the Small Business Administration shall monitor agency compliance with this chapter and shall report at least annually thereon to the President and to the Committees on the Judiciary of the Senate and House of Representatives, the Select Committee on Small Business of the Senate, and the Committee on Small Business of the House of Representatives.

"(b) The Chief Counsel for Advocacy of the Small Business Administration is authorized to appear as amicus curiae in any action brought in a court of the United States to review a rule. In any such action, the Chief Counsel is authorized to present his views with respect to the effect of the rule on small entities.

"(c) A court of the United States shall grant the application of the Chief Counsel for Advocacy of the Small Business Administration to appear in any such action for the purposes described in subsection (b).".

POSSIBLE VIOLATIONS OF THE OFFICE OF FEDERAL PROCUREMENT POLICY ACT BY THE OMB

The Office of Federal Procurement Policy Act (41 U.S.C. sec. 401 et seq.) establishes the Office of Federal Procurement Policy (OFPP) as a part of the OMB. The Act provides legal authority for the establishment of the Federal Acquisition Regulations (FAR), and contains recitations of policies, functions, and duties applicable to Federal buying agencies and OFPP.

OMB/OFPP may have violated this statute in the following three (3) ways:

(1) By memorandum, dated February 21, 1986, OFPP Acting Administrator David Baker directed DoD, NASA and GSA to publish a proposed change to the FAR that would have effectively repealed the "rule of two".

41 U.S.C sec. 405(a) states in relevant part that: "The Administrator (i.e. of OFPP) shall provide overall direction of procurement policy and leadership in the development of procurement systems of the executive agencies. To the extent that the Administrator considers appropriate, in carrying out the policies and functions set forth in this chapter, and with due regard for applicable laws and the program activities of executive agencies, the Administrator may prescribe Government-wide procurement regulations . . ." (emphasis supplied)

The February 21 memo does not afford "due regard for applicable laws" since it is an obvious distortion of the terms of the Competition in Contracting Act. In addition, DoD has on past occasion (DoD letters dated April 18, 1984 to David Stockman and December 31, 1984 to OFPP) indicated that repeal of the rule of two would adversely affect the acqusition system and impede the obtainment of legitimate acquisition objectives.

(2) 41 U.S.C. sec. 405(b) provides that in any instance when DoD, NASA and GSA "are unable to agree on or fail to issue Government-wide regulations . . . in a timely manner, the Administrator may, with due regard for applicable laws and the program activities of the executive agencies and consistent with the policies and functions set forth in this Chapter, prescribe Government-wide regulations . . ." (emphasis supplied)

In the instant case, there was never any disagreement among the three regulatory agencies. In addition, since the three agencies do not believe the "rule of two" is repealed by CICA, they cannot logically be faulted for not acting in a "timely" manner to repeal the rule. Accordingly, OMB's May 22 publication in the Federal Register may violate this provision of the Act.

(3) There are several provisions of the OFPP Act regarding small business that may have been violated. 41 U.S.C. sec. 405(e) provides in relevant part: "In carrying out the functions set forth in subsection (d) of this section (i.e. functions of the OFPP Administrator), the

Administrator (1) shall consult with the affected executive agencies, including the Small Business Administration."

The affected agencies and SBA were never consulted but merely informed of what OMB had intended to do.

. 41 U.S.C. sec. 405a (which was added to the OFPP Act by P.L. 95-507) provides in relevant part: "In formulating such regulations (i.e. the FAR) and procedures the Administrator of the Office of Federal Procurement Policy shall, in consultation with the Small Business Administration, conduct analyses of the impact on small business concerns resulting from revised procurement regulations . . ."

No such analysis was conducted prior to publishing notice of intent to repeal the "rule of two".

. 41 U.S.C. sec. 401 provides in relevant part: "It is the policy of the Congress to promote economy, efficiency, and effectiveness in the procurement of property and services by the executive branch of the Federal Government by - . . . (4) promoting the participation of small business concerns;"

Repeal of the "rule of two" - as stated by both the procurement agencies and representatives of small business concerns - will have an extremely adverse impact on small business.

Mr. MITCHELL. Mr. Torres, do you have an opening statement?

OPENING STATEMENT OF HON. ESTEBAN EDWARD TORRES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. TORRES. Thank you, Mr. Chairman.

Like you, I will not make this rollcall vote. I think it is important for us to stay here. I want to thank you for providing me with the opportunity to participate in this important hearing.

I also want to thank the witnesses for taking the time to appear today. I am certain that your testimony will help answer some of the questions that the May 22 OMB regulations have raised.

Frankly, Mr. Chairman, I, too, find it hard to believe that this hearing is even necessary. It is hard to believe that this committee is forced once again to defend small business participation in the Federal procurement process.

It is hard to believe that there are those in the administration who would destroy a program that promotes competition and lowers prices. It is hard to believe that there are those in the administration who would try to wipe out the small business set-aside program in the name of competition, and it is hard to believe that OMB has even issued these regulations after three other agencies refused to publish them.

Several months ago, I introduced legislation along with Chairman Mitchell that would prevent the repeal of the Rule of Two. My bill, H.R. 4097, takes the existing set-aside regulation and simply translates it into law. It protects the set-aside program from OMB by turning the Rule of Two regulation into a statute.

When I first introduced my bill, some of my colleagues on this very same committee did not believe that the administration was serious about eliminating this successful and very necessary program. In fact, one of my colleagues, who is not here today and I will not mention names, called my legislation totally unnecessary. He publicly accused me of needlessly spreading fear among small businesses when there were no plans to get rid of the set-aside program.

No one can deny the need for this legislation any longer. The regulations published in the Federal Register on May 22 by OMB saw to that. The threat to the small business set-aside program is now plain for all to see.

So, I urge the members of this committee, who have not yet cosponsored my bill, to do so. We must send a strong signal to the administration that Congress will not permit the Rule of Two to be repealed.

The Federal procurement system should not be closed to small businesses. High-priced toilet seats and hammers have shown the Nation that we need competition in the Federal marketplace.

Today's hearing will help ensure that small businesses are allowed to continue providing this competition.

Thank you, Mr. Chairman.

Mr. MITCHELL. Thank you very much, and I concur in everything that you have said.

We have a total of 13 witnesses. We have written statements from all 13 witnesses. We have had an opportunity to read those statements.

I would, therefore, respectfully request that when the witnesses testify that they do not read their testimony in its entirety. That total testimony will be submitted for the record.

I would request that the witnesses, when they testify, simply make the salient major points in their testimony, thus allowing us time to hear all the witnesses and allowing us time to raise questions.

I hope that you will try to cooperate with us on that request.

Panel 1 consists of the National Small Business Association, Mr. Richard D. Tobin, who is with Tobitron, Inc., East Hampstead, NH, and the National Federation of Independent Businesses, Mr. John Motley, director of Federal legislation.

If those two members would now come forward, we will receive your testimony.

Thank you both, gentlemen, for being here this morning. Again, thank you for taking time to be with us this morning. Good to see you.

Mr. Tobin.

TESTIMONY OF RICHARD D. TOBIN, PRESIDENT, TOBITRON, INC., EAST HAMPSTEAD, NH, ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Tobin. Mr. Chairman and members of the committee, I am Richard Tobin, president of Tobitron, a small electronics manufacturing company in Hampstead, NH. Prior to starting my own business in 1979, I spent 25 years as a consultant to the electronics industry working in large electronic companies in Massachusetts and New Hampshire, many of whom are prime contractors for the Government. My experience is that of a designer and engineer, and from that perspective, I will be testifying today. In addition, I am an appointed delegate to the 1986 White House Conference on Small Business, and a member of the board of trustees, National Small Business Association.

I am testifying on behalf of the NSB this morning. We appreciate the opportunity to express our views on the proposal of the Office of Federal Procurement Policy to eliminate the Rule of Two.

Mr. Chairman, if OFPP has a sound logical reason for making this proposal, the reason escapes us. Furthermore, we can find no valid reason to modify or change the practice that is working well. It is working well for the Department of Defense, the General Services Administration, the National Aeronautics and Space Administration; equally important, it is working well for small business.

The Rule of Two is critical in small business' ability to maintain the share of Federal procurement it currently receives, which is actually lower than what it should be receiving.

We are all familiar with the horror stories of cost overruns and outrageous charges and billings to the Government and, consequently, to the taxpayers. How many cases involve a small business in comparison to the number involving large prime contractors? Some people in Government believe that big is better.

These are some of the same people who want to see SBA moved under the Commerce Department. It seems so ironic that just when small business is finally being recognized for the significant contribution it makes in this country, we are being sent back to where we were 30 years ago.

If anyone on this committee would like to hear what really happens in prime contracting companies and why the cost is so high, I will be more than willing to meet with you at a later date and share with you what I have encountered during my 30 years in the industry.

Doing business with small business ensures that you not only will get a fair price, a faster service, but you will get the personal touch that the product deserves. You can rest assured that a cable produced at Tobitron for the Government will be personally touched by me because I, as a small business person, will be proud to have been awarded that Government job. How often does the president of a big corporation personally touch or inspect his product or even know what the product is in his building?

Chances are, however, that the small contracts that are reserved for set-asides are simply being used as fill-ins for major prime contractors between their annual or large contracts. The big difference to the Government would be the price. The average billing rate from a small firm compared to that of a major prime contractor with a high overhead is drastically different.

In many cases, the prime contractors charge the Government for staff that is not actually needed on the project. It is common knowledge in the industry that extra dollars will be charged for methods and manufacturing engineers for spare parts when, in fact, they are not needed at that stage of building a product. The cost for such personnel is only necessary when the product is being built for the first time and is not needed after documentation and floor support has been established.

Doing business with small businesses is good business; for small business, the Government, and the economy. Repeal of the Rule of Two could, anticipating spending levels, cost small business billions of dollars annually.

I need not remind you that the administration's grand plan for the dismantlement of the SBA includes not only withdrawing but dismissing certain PCR's. Add that to the potential damage of the repeal of the Rule of Two, and the prospects for small firms doing business with the Federal Government are not bright.

It is true that we have many obstacles to overcome when it comes to bidding Government jobs. One of the biggest obstacles is education of the Government procurement officers. They seem to be willing to accept without question the ridiculously high prices from big business.

But at least now we have the opportunity to bid because of the set-aside program, whereas, before, it was close to impossible. For a host of reasons, the profit margin in a small business is tighter than a large concern in the same field, although in my field, I can build a product for less than a large prime contractor.

In some types of business, the easiest way for big business to cut small business out of the market is by underselling them. It has been done before, it is being done now and no doubt will be done in the future. There is no way to prevent that.

Mr. Chairman, let me conclude by saying that the repeal of the Rule of Two is a bad idea. Small business in America stands willing to reduce the national deficit and save the taxpayers money because we are the taxpayers and we can help the Government by our involvement in direct Government contracts.

Repeal of the Rule of Two will run thousands of small businesses out of the Federal marketplace. It will destroy the set-aside program that provides nearly half of all the contracting dollars small firms get from the Government. It will likely impair to a serious degree the capital base of thousands of small businesses and, worse, it will jeopardize even further the competitive position of small business and increase the consideration of Federal contracting in big corporations.

I will be happy to answer any questions you might have, Mr. Chairman, and thank you.

[Mr. Tobin's prepared statement follows:]

PREPARED STATEMENT OF RICHARD D. TOBIN, PRESIDENT, TOBITRON, INC., ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Chairman and Members of the Committee:

I am Richard Tobin, President of Tobitron, Inc., a small electronics manufacturing company in Hampstead, New Hampshire. Prior to starting my own business in 1979, I spent 25 years as a consultant to the electronics industry working in the large electronics companies in Massachusetts and New Hampshire; many of whom are Prime Contractors for the Government. My experience is that of a designer and engineer and from the perspective I will be testifying today.

In addition, I am an appointed delegate to the 1986 White House Conference on Small Business and a member of the Board of Trustees of the National Small Business Association. I am testifying on behalf of NSB this morning.

We appreciate the opportunity to express our views on the proposal of the Office of Federal Procurement Policy to eliminate the "Rule of Two".

Mr. Chairman, if the OFPP has a sound, logical reason for making this proposal, the reason escapes us.

Furthermore, we can find no valid reason to modify or change a practice that is working well. It is working well for the Department of Defense, the General Services Administration and the National Aeronautics and Space Administration. Equally important, it is working well for small business.

The Rule of Two is critical in small business' ability to maintain the share of federal procurement it currently receives; which is actually lower than what it should be receiving.

It is important to remember that the Rule of Two does not mean that bidding is limited to only two small firms, but rather, that big business cannot bid.

It insures that a small business is going to get the contract; that there will be full and open competition among small business concerns and equally important, that taxpayers are going to pay a reasonable price.

We are all familiar with horror stories of cost overruns and outrageous charges and billings to the government and consequently to taxpayers. How many cases involved a small business in comparison to the number involving Large Prime Contractors?

Some people in government believe that big is better. These are some of the same people who want to see the SBA moved under the Commerce Department. It seems so ironic that just when small business is finally being recognized for the significant contribution it makes in this country, we are being set back to where we were 30 years ago.

Small business produces 45% of the Gross National Product; produces half of all major innovations at about 4% of what it costs big business and government to produce the other half, and is directly responsible for bringing this country out of its last recession. The manner in which the OFPP has interpreted the Competition in Contracting Act, forces contracting officers to justify in writing, the setting aside of contracts for bidding by small firms. More important, it offers big business, which already has complained that competition from small firms is "eroding" their sale of spare parts, a chance to have a "set aside" rejected merely by indicating they might bid.

If anyone on this Committee would like to hear what really happens in Prime Contracting Companies and why the cost is so high, I will be more than willing to meet you, at a later date and share with you what I have encountered during my 30 years of experience in the industry.

Getting the best price has not necessarily been contracting officers prime consideration. Remember the $400 hammers and $650 toilet seats. Their main objective is to get the item delivered according to specifications and on time. It is not reasonable to expect them to jeopardize that objective by making detailed surveys and written determinations prescribed in the proposed rule change.

Doing business with small business insures that you not only will get a fair price and faster service, but you will get the personal touch that the product deserves. You can rest assured that the cable produced at Tobitron for the government will be personally "touched" by me because I, as a small business person will be Proud to have been awarded that government job. How often does the President of a big corporation personally touch or inspect his product? How often in fact, does the President of a large corporation know what contracts for what products his company actually has in house?

Chances are, however, that the small contracts that are reserved for "set asides" are simply being used as "fill-in's" for major Prime Contractors between their annual or large contracts. One big difference to the government will be the price. The average billing rate from a small firm compared to that of a major Prime Contractor with a high overhead is drastically different.

In many cases Prime Contractors charge the government for "staff" that is not actually needed on the project. It is common knowledge in the industry that extra dollars will be charged for Methods and Manufacturing Engineers for spare parts, when in fact, they are not needed at that stage of building a product. The cost for such personnel is only necessary when the product is being built for the first time and is not needed after documentation and floor support has been established.

Doing business with small business is good business for small business, the government and the economy. Repeal of the Rule of Two could at anticipated spending levels, cost small business billions of dollars annually.

We have a historic precedent for what happens to small business when we tinker with the procurement process. Over two decades ago, Mr. Chairman, the Small Business Administration withdrew all of its Procurement Center Representatives from their posts in federal contracting offices around the country. Within months, there was a measurable drop in small business' share of federal procurement. Within three years from the date the PCRs were withdrawn, small business lost over 18 percent of its share of the federal procurement dollar. An 18 percent reduction in the $33 billion small business currently receives in federal procurement could mean a loss of approximately $6 billion annually. We do not believe small business can sustain its contribution to a healthy, viable economy if it is subjected to losses of that magnitude.

I need not remind you that the Administration's grand plan for the Dismantlement of the SBA includes not only withdrawing but dismissing certain PCRs. Add that to the potential damage of the repeal of the Rule of Two and the prospects for small firms doing business with the federal government are not bright.

Perhaps the most incredible aspect of the OFPP proposal is the statement that "The proposed revision of FAR Parts 6 and 19 is not expected to have a significant impact on a substantial number of small entities under the Regulatory Flexibility Act" and that "adoption of the sufficient number/lower reasonable cost" formula should not reduce the number of small business set asides.

It is true that we have many obstacles to overcome when it comes to bidding government jobs. One of the biggest obstacles is education of the government procurement officers. They seem to be willing to accept, without question, the ridiculously high prices from big business.

But, at least we now have the opportunity to bid because of the set aside program, whereas before it was close to impossible.

It is crystal clear that the person or persons sitting behind the desk peering into their book of regulations looking for something to change have never been in business, at least in a small business.

We must assume from the phrasing of the proposal that OFPP did not in fact conduct the feasibility study that the Regulatory Flexibility Act prescribes when regulation changes affect small business.

If that is the case, Mr. Chairman, we believe this total disregard for the law should be addressed by your Committee and the Congress.

I would like to tell the "Regulation Revisors" a little bit about what they should know about the effect on small business since they obviously have never been on my side of the equation.

For a host of reasons the profit margin in a small business is tighter than a large concern in the same field. Although in my field, I can build a product for less than a Large Prime Contractor, in some types of business the easiest way for a big business to cut a small business out of the market is by underselling them. It's been done before, is being done now and no doubt will be done in the future. There is no way to prevent it.

Mr. Chairman, let me conclude by saying that repeal of the Rule of Two is a bad idea. Small business in America stands willing to reduce the national deficit and save the taxpayers money, because we are the taxpayers and we can help the government by our involvement in direct government contracts.

Repeal of the Rule of Two will rule thousands of small businesses out of the federal marketplace. It will destroy the "set aside" program that provides nearly half of all the contracting dollars small firms get from the government. It will likely impair to a serious degree the capital base of thousands of small businesses and worse, it will jeopardize even further the competitive position of small business and increase the concentration of federal contracting in big corporations.

I will be happy to answer any questions you might have, Mr. Chairman. Thank you.

Mr. MITCHELL. Thank you very much, Mr. Tobin.

We will hold the questions until both witnesses have testified.

It is good to see you again, Mr. Motley.

Mr. MOTLEY. Thank you, Mr. Chairman.

Mr. MITCHELL. Please, proceed.

TESTIMONY OF JOHN MOTLEY, DIRECTOR, FEDERAL LEGISLATIVE AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. MOTLEY. First of all, let me thank you for holding these hearings and commend the committee for its interest in this subject.

We are also very grateful that NFIB and its 500,000 members have an opportunity to express its views here today on the OFPP's proposal to eliminate the Rule of Two test for competition in small business set-asides.

I will try to go through and summarize my statement very quickly, Mr. Chairman, in response to the time demands of the committee, and then answer any questions that you might have.

When we mention the Rule of Two and small business set-asides, we tend to conjure up the image of deals which are being struck between the Small Business Administration and the small business community and contracting officers.

I would submit to the committee that this is the farthest thing from the truth. More than half of all of the procurements of the Department of Defense come from negotiated sole source contracts. In this particular area, the small business share is extremely small, roughly 6 to 7 percent of those contracts which are let.

However, if you move to the most competitive area of Federal procurement, which is the formal advertising process, the small business share grows to 39 percent in 1984. What this shows is that small business actually does much better when there is intense competition, and we believe that the set-aside program and the

Rule of Two provides a means for the small business community to compete in this area.

Again, the inference when you discuss Rule of Two and small business set-aside is that the competition is only limited to two firms, and this simply is not the case. What it means is if two firms are available to bid on a particular small business procurement, then it can be set aside for smaller businesses.

In fact, it appears to us in studying the statistics that the Rule of Two actually increases the number of small firms which are competing for those contracts. In reality, using the Rule of Two standards, DOD averages 10 small businesses bidding for a set-aside, NASA 12, and GSA more than 10.

A brief comment, Mr. Chairman, on the use of the Regulatory Flexibility Act or, as we say, the misuse of the Regulatory Flexibility Act in this particular area.

NFIB believes that the reluctance or the refusal of OMB to do a regulatory analysis under the Regulatory Flexibility Act in this area is, in effect, a violation of the congressional intent of this law. We believe very strongly that congressional intent in the regulatory flexibility area is to provide a basis for very intense small business competition within the activities of the Federal Government, and we believe that the suggestion of OFPP to eliminate the Rule of Two will, indeed, reduce the amount of competition in the Federal procurement marketplace. To back up our point on this, let me read and quote from Defense Secretary Weinberger's letter to OMB Director Miller, seeking a reconsideration of the OFPP directive, and I quote:

> The Department of Defense operates a significant small business program. Not only because of the statutory provisions concerning small business, but because of the vital role played by small business in our industrial base. Key to the success of this effort are small business set-asides.

That is from April 6, 1986. And, further, as to the impact of the OFPP proposal, the Secretary says:

> These criteria, coupled with the determinations required by contracting officers, are likely to significantly impair the ability to make set-asides.

In summation, Mr. Chairman, NFIB believes that the small business set-aside program and the Rule of Two that makes it a viable procurement tool does three things:

First, it makes the Federal procurement process more competitive.

Second, it saves the taxpayers money.

Third, it provides small business with a fairer portion of Federal contracts.

Set-asides are not ideal. In fact, I believe in previous testimony before this committee, I have said that if NFIB had its choice in an ideal world, we would like to see all Federal procurements to be as highly competitive as possible, but the Federal procurement world certainly is not ideal, and we believe that the deck is stacked against small business and that the small business set-asides and the Rule of Two, which makes them viable, are very much needed.

Thank you, Mr. Chairman.

[Mr. Motley's prepared statement follows:]

PREPARED STATEMENT OF JOHN MOTLEY, DIRECTOR, FEDERAL LEGISLATIVE AFFAIRS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Good morning, Mr. Chairman. I am John Motley, Director of Federal Legislative Affairs for the National Federation of Independent Business (NFIB), a trade association which represents over 500,000 small and independent business owners across the nation. I appreciate this opportunity to open your hearing on the Office of Federal Procurement Policy (OFPP) proposal to eliminate the "rule of two" test of competition for small business set-asides. I am pleased to share this opportunity with Dick Tobin, an NFIB member and a member of this hearing panel.

In opening this morning's discussion, let me first lay the foundation for small business set-asides which dates to the 1953 Small Business Act:

> It is the declared policy of the Congress that the Government should aid, counsel, assist and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services of the Government be placed with small-business concerns,... and to maintain and strengthen the overall economy of the Nation. (Section 2)

Toward that end, procuring agencies were originally directed to set aside a contract or contracts if they:

> specifically determine that there is a reasonable expectation that offers will be obtained from a sufficient number of eligible concerns so that awards will be made at reasonable prices (emphasis added).

Unfortunately, the term "set aside" conjurs up notions of preferential treatment and sweetheart deals. I assert that this is not the case based on the facts of federal procurement.

While the dimensions of American small business are enormous, clearly their share of federal procurements is not. The small business contribution to GNP is some 38 percent. The value of the goods and services it produces makes American small business the world's fourth or fifth greatest economic power. Only the United States as a whole, Soviet Russia, Japan, and possibly West Germany's gross products produce more. Yet the impact of this power on the federal procurement budget has generally been only between 14 and 15 percent--less than half the small business share of GNP. Hardly a powerhouse unless you consider the playing field on which America's small business must compete for their own tax dollars.

The bulk of Federal contract expenditures are for DoD major weapon systems at the prime contract level, for which small firms inherently cannot compete effectively. (The importance of DoD procurements cannot be overstated. DoD has grown perceptibly from 73 percent of total federal prime contract dollars in FY 1979 to 80 percent in FY 1983.) The only practical way to ensure small firms are awarded a fair proportion of total dollars, as ascribed by the Congress, is to award them a larger share of contracts where small firms proliferate and are efficient performers: hence, set-asides.

Further, more than half of the procurement dollars are awarded under a negotiated noncompetitive method of contracting (see table), whereby the Government solicits an offer from a single source. The small business share under this most rigid contracting method has been about 6 to 7 percent. The most common method of spending federal procurement dollars is one in which small business participates the least.

However, when contracts are subject to competition, the proportion of contracts awarded to small business is significantly larger. And, in that contracting method providing the highest level of full and open competition--Formal Advertising--the small business share of procurement grew from 35% in FY 1980 to 39% in FY 1984. Given a level playing field, small business can compete. To the extent that they are shut out by the nature of the expenditure and the contracting method, small business must rely on set-asides to reach any level that might be deemed a "fair proportion."

In implementing set asides, the Navy found that the "sufficient number" standard--to which OFPP and OMB wish to return--was so vague and imprecise that contracting officers failed to set aside procurements even when ample small business competition existed. The Navy then instituted a requirement that a procurement must be set aside if there is a reasonable expectation that offers will be obtained from at least two responsible small business sources at a reasonable price. This requirement proved effective, was subsequently adopted by the entire Defense Department in 1978, by NASA in 1982, and became known as the "rule of two." The rule was adopted by all agencies in 1984

Set-aside dollars as a percent of total DoD awards are less than 10 percent. Through all methods of contracting, small enterprises maintain roughly 20 percent of the total DoD awards.

For all federal awards the numbers are approximately the same. Set-aside dollars are 5 to 6 percent of the total. Through all methods of contracting, the small business share is 15 to 16 percent. One might conclude that a more vigorous effort by DoD on behalf of small business, through rule of two implementation for set-asides, resulted in a more generous percentage. Clearly an effective set-aside program plays a significant role in apportioning any meaningful share of the federal procurement budget to small enterprises.

In any event, other businesses continue to harbor roughly an 80 percent take: not a bad split for less than one percent of the nation's businesses. How soon we forget that these are the guys who sold us $400 hammers and the like.

Part of the controversy over the "rule of two" stems from semantics. Opponents infer that competing sources are limited to two; nothing could be further from the truth.

The "rule of two" is not a limitation on the number of eligible competing sources. The rule is applied prospectively by a contracting officer to determine whether a procurement should be set aside. In reality, using the "rule of two" standard, DoD averages 10 small businesses bidding on a set-aside; NASA, 12; and the GSA, more than 10. In most instances, unrestricted procurements do not bring in this number of bids, this level of competition. The application of the rule is leading to increased competition for Federal contracts in areas where small firms are efficient performers, in areas where an expanded industrial base best serves the Nation's interest.

To this fact, let me quote from Defense Secretary Weinberger's letter to OMB Director Miller seeking a reconsideration of the OFPP directive:

> "The Department of Defense operates a significant small business program, not only because of the statutory provisions concerning small business, but because of the vital role played by small business in our industrial base. Key to the success of this effort are small business set-asides." (April 6, 1986)

And further, as to the impact of the OFPP proposal:

> "These criteria (sufficient number and lowest reasonable cost), coupled with the determinations required of the contracting officer, are likely to significantly impair the ability to make set-asides." (emphasis added)

In its proposed rulemaking, OFPP certifies that the proposed revision is not expected to have a significant impact on a substantial number of small entities under the Regulatory Flexibility Act (RFA).

For this reason, no initial impact analysis was done. This claim is absurd. As one of the champions of the RFA, NFIB would be remiss in not alerting your Committee and the small business community to this blatant oversight on the part of OFPP. The OFPP proposal flies in the face of the Congressional intent of maintaining competition and mitigating monopoly.

The legislative history of the RFA emphasizes the central importance of competition. Congress' intent is clear that regulations which propose to affect competition significantly should be included in the agency's RFA agenda and subjected to analysis.

Should there be any question as to the level of "significant" impact requiring RFA analysis, consider the House Report, which specifically advocates the case-by-case approach as the best way to decide the matter, stating in an example that the number of firms affected may be as low as 15 or even fewer and still trigger the Act's requirements (House Report 96-519, p. 13). OMB and OFPP are clearly negligent in executing their responsibilities under the RFA.

How can anyone suggest that the competitive consequences of such a change are insignificant, that such a change would not contribute to a decline of the small business market share? When set-asides represent 42 percent of small business prime contracts, is it not illogical to expect that tampering with the test for set asides would not have an effect?

OFPP also claims that a repeal of the rule of two test for set-asides is required under their interpretation of the 1984 Competition in Contracting Act (CICA). Actually, I should say their "new" interpretation; after its initial review of CICA, OFPP did not conclude that a revision of the regulation was required.

The issue at hand is not without further contradiction: why does CICA require "a reasonable expectation of receiving more than one sealed bid" as the standard for a sealed bid procurement, but as interpreted by OFPP, require a more stringent standard for small business set-asides? If two is not sufficient, is three? How can a contracting officer administer a "lowest reasonable cost" standard for an acquisition to be awarded under source selection criteria that subordinate cost to technical merit?

NFIB is aware of certain buying agencies experiencing difficulties with set-asides in some industrial areas because of size standards adopted by the Small Business Administration (SBA). However, we believe the solution to that problem is size standard reform, not repeal of the rule of two and the effective elimination of set-asides.

Not to belabor the point, the beauty of the RFA is that Congress recognizes the SBA definitions will not fit every regulatory situation. Under the RFA, agencies may seek to establish their own size standards, may consult with the SBA Office of Advocacy, and publish in the Federal Register the proposed size standards.

Under the RFA, an appropriate analysis would include specific demographic impacts to further address this problem. The RFA has real merit with this entire issue.

In sum, NFIB's concern here rests with support for small business set asides, competitive bidding, the cost-effective expenditure of their tax dollars, and recognition of the applicability of the Regulatory Flexibility Act.

Set-asides, and the rule-of-two which make them viable, provide an opportunity for the nation's most innovative enterprises to compete and make their mark. Small firms produce the greatest number of innovations using fewer financial resources and fewer people, and they can bring those innovations to market in only two-thirds the amount of time required by other businesses.

Set-asides are not the ideal, but they are the best mechanism to counter the imperfect realm of federal procurement. And to the extent that they are effective, we all benefit -- through new jobs, new ideas, and a more responsive competitive marketplace.

Contracting Methods, FY 1980 (Dollars)

	All Performers	Small Business	Small Business Percent of Total	Percent of Small Business Share
Formal Advertising	$ 9,454,977,000	$ 3,306,632,000	34.97	23
Small Business Set-Asides	5,182,326,000	5,182,326,000	100.00	36
Other Negotiated Competitive	19,352,930,000	2,053,683,000	10.61	14
Negotiated Noncompetitive	53,684,725,000	3,851,650,000	7.17	27
Other *	2,153,198,000	12,475,000	0	0
Total	$ 89,828,156,000	$ 14,406,766,000	16.04	

Contracting Methods, FY 1984 (Dollars)

	All Performers	Small Business	Small Business Percent of Total	Percent of Small Business Share
Formal Advertising	$ 10,621,685,000	$ 4,114,690,000	39.00	16
Small Business Set-Asides	10,766,185,000	10,766,185,000	100.00	42
Labor Surplus Area	514,755,000	120,893,000	23.00	0
Other Negotiated Competitive	45,544,237,000	4,774,339,000	10.00	19
Negotiated Noncompetitive **	89,873,924,000	5,593,007,000	6.22	22
Other *	10,406,684,000	22,471,000	.02	0
Total	$167,727,470,000	$ 25,391,585,000	15.00	

* Tariff or Regulated Acquisition & Directed for Foreign Governments
** Includes 8(a) set-asides

Calculations based on data from the Federal Procurement Data Center and Small Business Administration Office of Advocacy; percentages will not always add due to rounding.

Department of Defense Contracts
(Dollars in Billions)

	FY 1980	FY 1984
Total DOD Awards to Business	66.7	124.9
Awards to Small Business	13.6	23.8
Percent to Small Business	20.4	19.1
Set-Aside Dollars	4.8	12.3
Set-Aside Dollars are Percent of Total DoD Awards	7.2	9.8

Mr. MITCHELL. I thank you very much, Mr. Motley.

Am I right in assuming that your two organizations represent well over a half a million businesses? Is that correct?

Mr. MOTLEY. Yes, Mr. Chairman.

Mr. TOBIN. Yes.

Mr. MITCHELL. In your opinion, what would be the perception in the small business community if OMB is successful and the set-aside program is narrowed down?

I am not talking about the money that would be lost to small business, which is obvious—you have testified that there would be money loss. I am thinking more in terms of perceptions along the lines, of whether the Federal Government is really serious about cleaning up some of the waste in some of the agencies.

Is it really serious in its commitment to small business? That is what I mean by perceptions. Would you care to comment?

Mr. TOBIN. I would like to comment.

I think, at this point in time, the small business community is beginning to realize that the administration is really not tuned in to what is happening in the small business world.

No. 1, I think the actions taken in the last few months, such as the SBA trying to be moved under the Commerce Department, the White House Conference seems to us to be one of the biggest jokes that has come along in awhile. It does not have anyone on staff who knows or understands small business, and the point I am getting at is that I think this would be the straw that breaks the camel's back.

I think that we are becoming more organized. Just the fact that NFIB and NSB are sitting here together today tells me that the small business community is starting to unite. I think they have underestimated us, and I think that it is going to look to us that it is just another one of those bad situations where they do not understand us and know what is going on.

Mr. **Mitchell**. Thank you.

Mr. Motley.

Mr. **Motley**. Mr. Chairman, I think if you look at the total community, there is undoubtedly a group of small businesses who can read about this in the press and even compare the various ways Federal contracting is done and really not understand what is going on, and they have little or no opinion.

Those people are not involved in the process at all. But if you take the group of small businesses out there who are either participating or are capable of participating in the Federal procurement process and those from the activist part of the community, who have been involved in the process, the White House Conference, all along, I think that this is probably going to be seen as by them another unfortunate indication that the administration really does not understand the small business community in the United States, the role it plays in the economy, and the role that it can play in saving the taxpayers money in this process.

Mr. **Mitchell**. Thank you.

Mr. Tobin, I was concerned about your statement where you refer to the propensity of big business to cut a small business out of the market by underselling the smaller firm.

I understand what you are saying. I am concerned about it. In your opinion, is this a recurring practice that is fairly endemic?

Mr. **Tobin**. Well, I would think it is. I think I go on here to mention a little bit about the large prime contractors have been enjoying the $650 toilet seat for a long time, and it got very comfortable with it.

Mr. **Mitchell**. Yes.

Mr. **Tobin**. And I think that these fill-ins—there are already statements being made by large contractors, prime contractors, that they are, in fact, losing, it is eroding their little base, and they do not want to let go of that, and I think that everything is tying in very neatly to a package—you go from the SBA and having acting directors and acting leaders and the White House Conference, and it just seems to me that the small business community is in big, big trouble, and it has to come from somewhere, and I guess I would aim it toward big business.

Mr. **Mitchell**. Thank you.

Mr. **Motley**. Mr. Chairman, can I make a comment on that?

Mr. **Mitchell**. Yes.

Mr. **Motley**. I was in Pennsylvania yesterday at a NFIB statewide meeting, and two contractors from an engineering firm came up to me afterward and were complaining exactly about this type of process.

It appears from the conversations that I have had with members and others across the country that there are two things operating. One is the desire of the large prime contractors, big businesses, to keep as much of the business as possible, which is only natural in the competitive area.

The other is a desire, it appears, upon the contracting officers to make that possible for whatever reasons there are. Either because it is simpler to deal with one large contractor and let them take care of the rest.

These two NFIB members were in the engineering business, and they were complaining about the tendency of the Department of Defense to roll engineering contracts together, to the point where they believed that no small business is going to be able to bid on the contracts because no small business is going to have the capability of bidding on them.

Mr. MITCHELL. Thank you.

I have just one other question for you, Mr. Motley.

In my opening statement, I refer to the necessity to look at size standards, do something about them. Unfortunately, a majority of this committee, which I chair, does not share my opinion.

You said in your statement that size standards are the real problem in certain industrial areas. I fully agree with you. I know that you have attempted to interface with SBA on a fairly regular basis.

Do you see any significant movement within SBA with regard to size standard reform?

Mr. MOTLEY. No, Mr. Chairman, I do not.

Mr. MITCHELL. Thank you very much.

Mr. Torres.

Mr. TORRES. Mr. Chairman, I have no questions at this time.

Mr. MITCHELL. All right. I do not know the order in which people arrived, but Mr. Gallo, do you have questions?

Mr. GALLO. I have no questions.

Mr. MITCHELL. Mr. Hayes.

Mr. HAYES. Thank you, Mr. Chairman. Did I understand you correctly that the combined organizations here represent some 500,000 small businesses?

Mr. MOTLEY. Mr. Hayes, NFIB has about 530,000 members of its own.

Mr. HAYES. Of its own? And what percentage of that is minority?

Mr. MOTLEY. We do not collect that information, Congressman, so it would be difficult for me to give you a firm answer.

My feeling is, having talked with NFIB's people who are out working with the membership, is that minorities tend to join in fairly large numbers.

Mr. HAYES. When you convert that into that 500,000 plus that you represent, what does that mean in terms of jobs?

Mr. MOTLEY. Well, roughly, the average NFIB member has nine employees. So, you are talking about 4.5 million jobs.

Mr. HAYES. Four million. Of course, we are not talking about total elimination of small business, but as they go out, my point is it does have an adverse impact on the already sick job market. We have a lot of people who are out of jobs, looking for work, and I think we ought to be about the business of trying to find ways and means to help them find jobs, not create situations where they are going to lose more jobs.

I certainly want you to know that I am supportive of the position you have taken, and I want to see the set-aside program retained.

This is one of my chief concerns because I represent a district where unemployment is very high and whatever businesses still exist there are mostly small businesses.

Thank you, Mr. Chairman.

Mr. MITCHELL. Thank you.

Mr. Dreier, do you have questions?

Mr. DREIER. Thank you very much, Mr. Chairman.

I, too, would like to echo my concern about OMB's proposal to do away with the Rule of Two, and I would like to follow up also on a question that you raised, Mr. Chairman, and I share your sentiment on this, too, and that has to do with size standards.

You asked Mr. Motley about action at the SBA. I would simply like to follow it up by asking to what he attributes that lack of action or movement in the area of size standard reform?

Mr. MOTLEY. Congressman Dreier, I do not really know if I can answer that question. You know, size standards is one of the highly politicized areas at SBA where you have standards being changed in response to pressures from Congress to get fairly significant constituent firms involved in Federal procurement.

I really do not know if it is feasible to undertake a complete rewrite of the standards, and if they did, in which direction they would go. If you go out to any of the White House conference meetings which are being held, I think it is fairly obvious that the small business community in this country does not consider firms that have 500 employees to be small.

Most of them are suggesting either a two- or a three-tier set of size standards with SBA helping focus on the smaller firms. I really do think that if SBA were to get into a general review and rewrite of size standards, they would be opening up Pandora's box.

Mr. DREIER. Well, then, other than the fact that the chairman has simply—I have been trying to help him on this—not been able to get enough votes, what he attributes the failure in this committee to move it.

Mr. MITCHELL. Would the gentleman yield?

Mr. DREIER. Yes, sir, Mr. Chairman.

Mr. MITCHELL. You posed a question that even I do not know the answer to, and I am not——

Mr. DREIER. But the witness may, though, Mr. Chairman.

Mr. MITCHELL. All right.

Mr. MOTLEY. I really do not think I have the answer to that one, Congressman.

Mr. DREIER. OK. Thank you very much, Mr. Chairman.

Mr. MITCHELL. Thank you, Mr. Dreier.

Congressman Ireland.

Mr. IRELAND. Thank you for your courtesy, Mr. Chairman. I might have a question later, but I do not at the present time.

Thank you.

Mr. MITCHELL. Thank you.

Gentlemen, thank you very much for your testimony. Appreciate it.

Mr. MOTLEY. Thanks for inviting us, Mr. Chairman.

Mr. MITCHELL. Our next witness is Mr. Seymour Efros from the General Accounting Office. He is the Associate General Counsel for Procurement and Transportation Law.

Mr. Efros, if you will come up, please.

Thank you for being with us this morning.

Mr. EFROS. Thank you.

Mr. MITCHELL. As I indicated previously, because we have such a long list of witnesses and we do have your testimony, which will be submitted in its entirety for the record, if you could summarize your testimony, we would be most appreciative.

TESTIMONY OF SEYMOUR EFROS, ASSOCIATE GENERAL COUNSEL, PROCUREMENT AND TRANSPORTATION LAW, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JOHN BROSNAN, GROUP MANAGING ATTORNEY, OFFICE OF GENERAL COUNSEL, AND KEVIN TANSEY, GROUP DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

Mr. EFROS. I wonder if I may first introduce John Brosnan on my left, who is from our legal staff, and Kevin Tansey from our audit staff.

Mr. Chairman, members of the subcommittee, you have asked me to describe any inquiries made by the committees of Congress to GAO with respect to whether the Rule of Two is in conformity with the Competition in Contracting Act of 1984 [CICA].

Mr. MITCHELL. Excuse me. I think you need to pull your mike just a little bit closer to you.

Mr. EFROS. Thank you, Mr. Chairman.

Our consideration of the Rule of Two occurred in connection with the work of the GAO task force on CICA implementation. We created the task force in response to a joint request from the chairman and the ranking minority member of the House Committee on Government Operations and the chairman and ranking minority member of the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs.

A number of issues were raised by the staffs of the committees for consideration by the GAO task force, including whether CICA prohibits the use of the Rule of Two.

In early July 1985, we advised the staff of the House Committee on Government Operations of our conclusion that CICA did not preclude use of the Rule of Two as a set-aside standard.

Essentially, we concluded that the authority under the Small Business Act to set aside a procurement whenever it is determined to be in the interest of ensuring that a fair proportion of contracts are awarded to small businesses was left intact. Of course, once the set-aside is made, the procuring agencies are under a duty to maximize competition, to get as much competition as possible.

In view of our conclusion that the existing regulation, the FAR's Rule of Two, was consistent with the Competition Act, we saw no reason to include a discussion of the subject in our report, which we issued in August 1985, discussing what changes were needed in the regulations to conform them with the new Competition Act.

That, Mr. Chairman, is essentially my statement.

[Mr. Efros' prepared statement follows:]

PREPARED STATEMENT OF SEYMOUR EFROS, ASSOCIATE GENERAL COUNSEL, PROCUREMENT LAW SECTION, OFFICE OF THE GENERAL COUNSEL, GAO

Mr. Chairman and Members of the Subcommittee, you have asked me to describe any inquiries made by any committee of the Congress to the GAO with respect to whether the "rule of two" is in conformity with the Competition in Contracting Act of 1984 (CICA), and the nature of the responses offered by us. As you know, the rule of two refers to the provision in the Federal Acquisition Regulation (FAR) that requires a procurement to be set aside exclusively for small business participation if the contracting officer determines that there is a reasonable expectation that offers will be received from at least two responsible small business concerns, and that award will be made at a reasonable price.

Our consideration of the rule of two occurred in connection with the work of a GAO task force on CICA implementation. We created the task force in response to a joint request in August 1984, from the Chairman and the Ranking Minority Member of the House Committee on Government Operations, and the Chairman and Ranking Minority Member of the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, to review the implementation of CICA in the FAR and other regulations.

In discussions during October and November, 1984, a number of issues were raised by the staffs of the Committees for consideration by the GAO task force. As a result of these discussions and its own analysis of the regulations, the task force drafted a list of possible issues for review, including whether CICA prohibits use of the rule of two. Subsequently, as our task force was nearing completion of its work in early July, 1985, we advised the staff of the House Committee on Government Operations of our legal conclusion that CICA does not preclude use of the rule of two as a set aside standard. Given our conclusion on this issue, we and the staff agreed that there was no need to include a discussion of the rule of two in our report entitled "Federal Regulations Need to Be Revised to Fully Realize the Purposes of the Competition in Contracting Act of 1984," (subsequently issued August 21, 1985).

The legal question involved was whether section 2732(b)(2) of CICA (41 U.S.C. § 414) precludes use of the rule of two as a standard for small business set-asides. That section provides that the contracting agencies are to increase the use of full and open competition by establishing policies that ensure receipt of a sufficient number of offers so that awards will be made at the lowest reasonable cost. In the House and Senate Conference Committee report on CICA, the conferees stated that this requirement applies to all procurements, including those made under set-aside programs.

We concluded, however, that section 2732 does not affect the broad discretion of a contracting agency under section 15 of the Small Business Act (15 U.S.C. § 644) to determine when a set-aside is appropriate. In our view, CICA does not change the authority of the agencies under the Small Business Act to set aside a fair proportion of procurements by a standard deemed appropriate, including the rule of two. Section 2732 of CICA and the statement in the conference report merely affirm that an agency is required to seek full and open competition among small businesses once a particular procurement has been set aside.

Mr. **Mitchell**. Thank you very much.

If I understand you correctly, the issues for review were formulated by GAO and the House and Senate committees. That is correct, right?

Mr. **Efros**. Yes.

Mr. **Mitchell**. Then, after GAO concluded that CICA does not require repeal of the Rule of Two, the decision to delete the issue from the report was made only by GAO and the House Government Operations Committee, is that correct?

Mr. **Efros**. We had a list of issues which we presented to the people who participated in revising the FAR. I think we distributed the list in the fall of 1984. The Rule of Two was one of the issues. Citing the provision of CICA, we had a question of whether that rule was in conflict with CICA.

In the task force work, we had a lot of issues, including the Rule of Two. When the time came to issue the report, about June or July 1985, we had input from all the parties involved with FAR. We had talked to DOD, and we had talked to all the other parties and had gotten their views, and then we formed our position, our in-house position, which was that the Rule of Two was not contrary to CICA.

The main purpose of the report, as the title suggests, was to cite changes that needed to be made in the regulations to conform them with CICA. So, we orally communicated our finding to the House committee staff that we did not see any conflict between CICA and the Rule of Two, and we did not include our finding in the report since the report was basically addressed to making changes in the FAR.

Mr. **Mitchell**. In retrospect, considering the fact that the Office of Management and Budget is pushing here to try to repeal the Rule of Two, would it not have been prudent to have had that issue included in your report?

Mr. **Efros**. It probably would have been relatively simple for any of the agencies to have written to us and requested our opinion on the Rule of Two. I think we would not have hesitated to give a formal opinion.

Mr. **Mitchell**. That does not quite respond to my question.

Mr. **Efros**. Oh. Mr. Tansey.

Mr. **Tansey**. The request, Mr. Chairman, was to identify issues that needed to be changed in the regulations, and once we concluded that no change was needed, it did not fit within the agreed-upon scope of work with the two committees.

In answer to your earlier question, we did advise the Senate subcommittee staff as to our conclusion on this, and they had no problem.

Mr. **Mitchell**. I do not want to push this, but were you aware of the fact that OMB was continuing in its efforts to try to repeal the Rule of Two?

Mr. **Tansey**. Not at that time.

Mr. **Mitchell**. You were not.

Mr. **Tansey**. Not at that time, no. We met with OFPP officials, and they did not express that view at that time.

Mr. **Mitchell**. Congressman Torres.

Mr. **Torres**. No questions at this time, Mr. Chairman.

Mr. MITCHELL. Congressman Gallo.

Mr. GALLO. Thank you, Mr. Chairman.

Mr. Efros, have you had an opportunity to review the opinion that has come out of OMB dealing with this particular issue?

Mr. EFROS. I read the public announcement, yes, and, basically, they point to language in CICA which talks of policies, practices, and procedures of the agencies designed to obtain a sufficient number of bids to assure award at the lowest price, if I am paraphrasing the language correctly. OFPP's position is that this language requires the agencies to have a set-aside standard which, in effect, repeats that language, the sufficient number standard which used to be, I think, the FPR standard, before FAR went into effect.

Mr. GALLO. I strongly favor the Rule of Two, but, at the same time, you had that opportunity to review OMB's proposed rule. Do you have any opinion on their ruling with regard to the areas you mentioned?

Mr. EFROS. The opinion that we reached in June or July 1985 is that the set-aside provision of the Small Business Act, which has been in effect for many years, about 30 years, is very broad, and the agencies have always operated under a very broad mandate to set aside procurements whenever they deemed it to be in the interest of assuring that small business gets a fair proportion of Federal contracts.

Now, I think that if we are going to have a change in that broad set-aside standard, the legislative history and the language, in my opinion, is going to have to be a little more specific than this language in CICA, and that is the way I come out.

Mr. GALLO. So, in your opinion, there is some doubt as to the regulation itself?

Mr. EFROS. I think that the regulation—the Rule of Two—is consistent with the procurement statutes, as I interpret them.

Mr. GALLO. This opinion came out May 22 or thereabouts?

Mr. EFROS. May 1986.

Mr. GALLO. You are dealing with an opinion issued in 1985, that your agency came up with?

Mr. EFROS. It was not a formal opinion. It was an in-house conclusion that was reached. We did not issue any paper on that.

Mr. GALLO. What I am trying to get at is as a result of this opinion. Have you reviewed it thoroughly enough to indicate whether or not you feel firmly that there is no need for the proposed regulation, or is there a question in your mind as to the clarity of the law as it now stands? Maybe additional legislation may be necessary.

Mr. EFROS. I want to answer your question directly. The procuring agencies always had authority and discretion to adopt either standard as a set-aside standard, the Rule of Two or, the sufficient number standard. In fact, that was the situation for many years.

They could do both. The question is whether the legislation, CICA, which was passed in 1984 and went into effect in 1985, has changed that. OFPP apparently has concluded that it has.

I think it has not. I think that the present law, to my mind, is reasonably clear that the agencies, if they wish, can choose to stay with the Rule of Two.

Mr. GALLO. And/or.

Mr. EFROS. And/or, exactly.

Mr. **Gallo**. Thank you.

Mr. **Mitchell**. Congressman Hayes.

Mr. **Hayes**. Thank you, Mr. Chairman.

Just one question for clarity: Does GAO have any opinion on the retention or elimination of the 10-percent set-aside program?

Mr. **Efros**. Did you say the 10-percent set-aside program?

Mr. **Hayes**. No, sir; it is a set-aside program.

Mr. **Efros**. Oh. I do not know whether we have information to tell us whether the present set-aside program is as effective as it might be or not. Maybe Mr. Tansey knows.

Mr. **Hayes**. It would not bother you if it is retained, would it?

Mr. **Efros**. Not legally. As a legal matter, we think that——

Mr. **Hayes**. What about principally?

Mr. **Efros**. Oh, I do not have the information. I leave that to the policymakers.

Mr. **Mitchell**. You are sure you are not associated with the State Department? [Laughter.]

Mr. Dreier.

Mr. **Dreier**. Thank you very much, Mr. Chairman.

I would like to thank you, Mr. Efros, for your very cogent testimony.

I have a copy of the May 7 letter that Mr. Wright sent to the Secretary of Defense, and I would like you to give us your thoughts about the second to last paragraph in that letter in which he says:

> It's also very important to note the cognizant subcommittee chairman and ranking minority member of the Senate Governmental Operations Committee and the chairman and ranking minority member of the House Government Operations Committee and the chairman and ranking minority member of the House Appropriations Subcommittee on Military Construction, have advised this office that the changes are necessary to properly implement provisions of CICA.

I wonder what your association and discussions with them have consisted of.

Mr. **Efros**. I have not had any direct discussions with any of the staff people that I recall.

Mr. **Dreier**. Or any of the members at all?

Mr. **Efros**. None that I recall. I would be glad to have Mr. Brosnan and Mr. Tansey, who did work with the committee staff members, respond. But I think, based on what I have heard from our task force staff, that the committee staff felt that the language in CICA, the language cited by OFPP in its justification for the change, was intended to require the so-called sufficient number of set-aside standards.

My view is that if you are going to overturn a longstanding set-aside standard, I want to have it very clear in the legislation.

Mr. **Dreier**. Do any of your colleagues have any specifics that they might like to share?

Mr. **Brosnan**. Well, the committee staffs expressed the view consistent with the view that you read in that letter, and we took a look at it independently and just ended up not agreeing with them.

They expressed their view vigorously, but that was it.

Mr. **Tansey**. I might add, the only committee staffs that we did work for under our request were those of the House Government Operations and the Subcommittee on Oversight of Government

Management, Senate Governmental Affairs. So, those two committees were the only ones that we dealt with on this issue.

Mr. **Dreier**. OK. Thank you, Mr. Chairman.

Mr. **Mitchell**. Congressman Ireland.

Mr. **Ireland**. No questions, Mr. Chairman. Thank you.

Mr. **Mitchell**. Thank you.

Gentlemen, thank you very much. Appreciate your being here.

Mr. Charles Heatherly, the Acting Administrator of the Small Business Administration, could not be with us this morning. I think his testimony is critical, and, therefore, we will hear from him as a lone witness in another hearing. We will give him 10 days to try to rearrange his schedule, but he will be the lone witness in another hearing.

Mr. Frank Swain, who is the chief counsel for advocacy of the Small Business Administration, is present with us, and we thank you for being here.

We have a copy of your testimony. It will be submitted in its entirety for the record.

TESTIMONY OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. **Swain**. Thank you, Mr. Chairman.

Because of the number of witnesses and the variety of interests, I will attempt, as you have requested, to summarize the points that we have made in our prepared statement.

Basically, we believe that the Rule of Two makes sense and has had a good record from a policy perspective of encouraging the maximum utilization by buying agencies of small businesses, and, at the same time, assuring that we receive quality goods and services at a competitive price.

In fact, the records indicate that there is a good deal more competition in most procurements than just two. Under the current Rule of Two or more standards, the Department of Defense averages 10 small businesses bidding on set-asides; NASA 12 small businesses; and GSA more than 10. We think that, from a policy perspective, the Rule of Two has worked well and we see no particular reason to change it.

From a legal perspective, addressing your question as to whether the Competition and Contracting Act requires the changes that the Office of Federal Procurement Policy is proposing, we do not think that it does for basically the same reasons that the General Accounting Office witnesses indicated.

The standard in the Competition and Contracting Act calls for a sufficient number of bidders to guarantee competitive purchase. It seems to me that it is perfectly within the ambit of the law to define that sufficient number as two or more.

Second, the Competition and Contracting Act was followed by enactment of other laws, including the Small Business Competition Enhancement Act, which contains language specifically stating that small business set-aside procedures fall within the ambit of the definition of competitive competition.

So, therefore, we do not believe that there is any legal necessity through the Competition and Contracting Act to change the existing Rule of Two.

Insofar as the adequacy of the notice, we believe that the notice of proposed change by the Office of Federal Procurement Policy is thus far not adequately in compliance with the Regulatory Flexibility Act. The notice attempts to certify that the proposed change would have no significant impact on a substantial number of small firms.

Inasmuch as the Rule of Two, which is the basis for small business set-asides, results in approximately half of all of the small business purchases by the Government being made through set-asides, it seems clear that if you significantly change that procedure, it will, indeed, have some significant impact on a substantial number of small firms.

Now, I cannot tell you what that impact is. A good deal of the information that you have requested is being provided this morning by a number of the buying agencies. I would suggest that it is important to look at and to assess what that impact might be. But at the very least, the Office of Federal Procurement Policy should realize that the proposed change, if it were to go into effect, would have that significant impact and the office, I believe, is under the obligation to do an analysis, more specifically, of what that impact is.

Also in relation to the Regulatory Flexibility Act, of course, the act not only calls for an analysis, but a suggestion by the agency as to what lesser alternatives might be appropriate to accomplish whatever the stated end of the rulemaking is. This leads us to your other question that you posed to us: Is the issue of the Rule of Two not, in effect, part of the issue of size standards?

We would suggest that from our point of view, there is no reason to change significantly either the Rule of Two or the size standards. We regard the system as not particularly broken and not in this regard—in necessity—we do not need a major fix.

However, if there are particular buying categories in which various people think that there are problems that the Rule is acting or is achieving an inappropriate result or the size standards are off, then it seems to me that there are many less broad alternatives. We could have a rule of three, four, or five, or six in certain buying categories, but I am sure there are other alternatives.

As the chairman has indicated, there is always an alternative that the SBA could adjust its size standards in a particular buying commodity because, of course, it is two sides of the same coin. We think that the Office of Federal Procurement Policy is perfectly within its rights to focus on whatever problems it thinks exist. We would prefer to see a broader discussion of whatever the appropriate alternatives are beyond this very broad and significant change to the Rule of Two.

I would be happy to try to respond to any questions, Mr. Chairman.

[Mr. Swain's prepared statement follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

PREPARED

STATEMENT OF

HONORABLE FRANK S. SWAIN

CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON SBA AND SBIC AUTHORITY, MINORITY ENTERPRISE

AND GENERAL SMALL BUSINESS PROBLEMS

OF THE

SMALL BUSINESS COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

JUNE 5, 1986

SUMMARY

- Nearly 50 percent of all small business contract dollars are awarded to small business through the set-aside program. The "rule of two or more" is a convenient tool for determining when set-asides should be made, and therefore, is essential to small business.

- The Competition in Contracting Act does not require any change in the "rule of two or more."

- The Office of Federal Procurement Policy's (OFPP) proposed rulemaking to change the "rule of two or more" does not fully comply with the Regulatory Flexibility Act of 1980.

- Advocacy Research has found that small business does not receive a disproportionally large share of federal contracts in procurement categories so that a change in the "rule of two or more" would not be justified.

  In this research, a comparison was made between small business share of Federal Government sales and private sector sales. The comparison indicates that in all four major procurement groups (construction, R&D, all other services, and supplies and equipment) small business has a smaller share of government sales than of industry sales.

Mr. Chairman:

Thank you for this opportunity to present my views on the fundamental change in the set-aside program proposed by the Office of Federal Procurement Policy (OFPP). The set-aside program, designed to insure that small businesses receive a fair proportion of Federal contract dollars, allows small business to compete among themselves to provide the government with good products at reasonable prices. It is a competitive program and has been enormously successful in bringing small businesses into the contracting arena. Latest figures show that nearly 50 percent of all small business contract dollars are awarded to small business through the set-aside program.

As you are well aware, the "rule of two or more" constitutes the standard for competition in the set-aside program and has been developed and adopted by the three procurement rulemaking agencies, the Department of Defense (DOD), the General Services Administration (GSA) and the National Aeronautics and Space Administration (NASA). The "rule of two or more" states that a contracting officer shall set aside for small business any contract for which there is a reasonable expectation that two or more small businesses will submit bids at a reasonable price. Under the current rule of two or more standard, DOD averages 10 small businesses bidding on set-asides, NASA, 12;

and GSA, more than 10. Despite this admirable record, OFPP, on May 22, issued a notice of proposed rulemaking to eliminate the "rule of two or more" and substitute a sufficient number/lowest reasonable cost standard. I am particularly concerned about the practical effect of this proposed change. This indefinite standard, coupled with the detailed written statements required from contracting officers to justify set asides, will significantly reduce the number of contracts set aside for small business competition.

Under the proposal, contracting officers will be required to determine not only that adequate small business competition exists, but also that the resulting contract will be let at the lowest price. This means that in any situation where a large business indicates an interest in bidding on a requirement, contracting officers could not set aside the procurement because they could not be assured that a small business bid would be the lowest. The inclusion of large businesses in the process of determining the price will, in many cases, eliminate the set-aside program for all practical purposes. In those rare cases where a contracting officer can determine that only small businesses are expected to submit bids, thus satisfying the "lowest reasonable cost" requirement, small business set-asides would be unnecessary.

The proposal would undermine an essential goal of the Small Business Act to expand competition and the mobilization base by limiting the concentration of contracts in small numbers of large businesses. The present "rule of two or more" is an effective tool in achieving this goal. Our experience is that it actually encourages larger numbers of small businesses to bid, since they will compete against their peers rather than against a few corporate giants. At the same time, the government is assured that it will procure its needed goods and services at reasonable and competitive prices.

Finally, the proposal would run counter to the longstanding national goal contained in Section 15 of the Small Business Act of ensuring that a "fair proportion" of the Government's purchases are placed with small business. The Small Business Act directs the Administrator to establish annual goals for each agency in awarding contracts to small business. The only way an agency can guarantee that sufficient awards will be made to small business is through a set-aside program. Making a set-aside program work, however, requires having a definite and easily implemented triggering device such as the "rule of two or more." The present proposal would substitute an indefinite and unmanageable standard for a simple, efficient and proven procedure.

Does CICA Mandate Repeal of the "Rule of Two or More?"

The Competition in Contracting Act, P.L. 98-369, does not require elimination of the "rule of two or more" to justify small business set-asides. The OFPP cites the "full and open competition" language in Section 2732 of CICA as the mandate for their proposal. However, this language must be viewed in connection with technical amendments to the CICA which were included in the "Small Business and Competition Enhancement Act of 1984" (P.L. 98-577).

In short, CICA mandates the use of competitive procedures in order to implement the ultimate policy goal of full and open competition in Federal procurement. The Small Business and Competition Enhancement Act correctly recognizes that current small business set-asides are competitive and includes them within the definition of competitive procedures of CICA. Thus, P.L. 98-577 amended both the Armed Services Procurement Act (ASPA), and the Federal Property and Administrative Services Act (FPASA), to recognize the validity of present set-aside procedures as an acceptable form of competitive procurement. Section 303(b) of the FPASA, and the corresponding section of the ASPA, now specifically state that:

> An executive agency may provide for the procurement of property or services covered by this section using competitive procedures, but excluding other than small business concerns in furtherance of sections 9 and 15 of the Small Business Act (15 U.S.C. 639, 644).

Furthermore, Section 309(b) of the FPASA, and the corresponding section of the ASPA, defines "competitive procedures" as including small business set-asides "as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete."

Read together, these provisions simply mean that small business set-asides do provide full and open competition under competitive procedures so long as the procuring agency does not limit the number of eligible small business concerns that may submit bids in response to the set-aside. Since the present "rule of two or more" clearly complies with these requirements, there is simply no statutory basis for concluding that it is in any way contrary to CICA as amended.

Does the Notice of Proposed Rulemaking Comply with the Regulatory Flexibility Act of 1980?

Assuming that OFPP does have independent authority to promulgate a binding regulation in this situation, I am not satisfied with the putative Regulatory Flexibility Act compliance. OFPP's RFA compliance was attempted with a statement that the proposed change "is not expected to have a significant economic impact on a substantial number of small entities." This certification appears faulty on its face. A major change to procedures through which 50 percent of all small business contract dollars are awarded will have a substantial impact.

The statement of rationale ignores the reality that although the mandate of the Small Business Act will be intact, it will be much more difficult to comply with it because set-asides will be harder to justify. There has been no attempt to quantify how these new procedural hoops will reduce the number of set-asides.

Figures produced by the Federal Procurement Data System show what may happen. In Fiscal Year 1979, the first year data was collected, small businesses won only about 15 percent of total prime contract dollars. Of this 15 percent, about 36 percent was won through set-asides. Over a six year period, to Fiscal Year 1985, the set-aside percentage of total Federal small business procurement has increased to approximately 50 percent. All during this time, the "rule of two or more" has been in effect at the Department of Defense, which constitutes approximately 70-80 percent of Federal procurement. Despite this, the small business share of procurement has declined. Since this is the case, this is hardly the appropriate time to toughen the standards for set-asides, as it would become even more difficult for Federal agencies to ensure that small business receives a fair proportion of Federal contracts.

The detrimental small business impact results from the ambiguous and contradictory instructions provided to contract officers of when and how lowest reasonable costs should be determined. Prior to the FAR, civilian agencies utilized the standard of "reasonable expectation that bids or proposals will be obtained from a sufficient number of responsible concerns....so that awards will be made at reasonable prices." (FPR 1-1.706-5). In the notice of proposed rulemaking OFPP suggests that they are returning to this standard. However, this ignores the fact that the Federal Procurement Regulations (FPR) also included a definition of "adequate price competition" which relied on price information submitted by small business and did not factor in big business bids. The FPR stated that "price competition exists if offers are solicited and (A) at least two responsible offerors" which can satisfy the Government's requirements independently compete by submitting priced offers responsive to the expressed requirements of the solicitation (FPR 1-3.807-1(b)(1)). Based on this, the SBA often argued convincingly that two small businesses were enough to constitute a "sufficient number."

In essence, the statement of rationale provides no facts or other assurance that the rule will not in fact have a "significant economic impact on a substantial number of small entities." For these reasons, I believe, assuming the OFPP has authority to promulgate this change, it should be required to conduct an Initial Regulatory Flexibility Analysis which would describe "any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities."

Are Faulty Size Standards Contributing to the Set-Aside Problems Improperly Attributed to the Rule of Two or More?

First, let me state that I don't think that set-asides or the rule of two or more is a problem. As I have said it is a good program, is easily implemented and has greatly benefited the small business community. I do believe, however, that some of the criticism directed toward the rule of two or more has been fostered by those who seek to change some of the SBA size standards.

Set-asides are established to assure that a fair proportion of contract dollars go to small businesses, both to encourage competition in government contracting and to insure the continued existence of a broad defense industrial base. Much debate has been focused on what is a fair proportion for small business.

It is important to note that Federal law dictates that a "fair proportion" of the government's total purchases and contracts for goods and services are placed with small businesses. Since the bulk of Federal contract expenditures is for DOD's weapons systems and other major requirements, the only practical way to ensure that small firms get a fair proportion of total dollars is to award them a larger share of contracts in areas where small firms proliferate and are efficient performers. Such areas include contracts for supplies and equipment; construction; architect-engineering services; testing and evaluation; maintenance and repair; and management, professional and technical services. In these areas, small firms could be expected to garner a significant share of total contract dollars, even if a rule of six, eight, or ten were adopted.

It is in these areas that there is a significant relationship between set-asides and size standards. Obviously, the higher the size standard, the greater the number of small businesses eligible to compete for set-asides. In some very specific areas, this has led to what some believe to be a disproportionately large share of contracts being awarded to small businesses. However, research conducted for our office does not bear this out.

In this research a comparison was made between small business share of Federal Government sales and private sector sales (procurement weighted to reflect that the Federal Government does not buy the same mix of goods and services as the economy as a whole). This comparison indicates that in all four major procurement groups small business has a smaller share of government sales than of industry sales. I have attached a summary of this study to my testimony.

One area of special interest is construction where there is often criticism that small business gets too many contracts. In 1983, the small business share of total industry construction sales was 56.18 percent while their share of Federal procurement sales was only 52.17 percent. Of small business' total procurement share, 67 percent was awarded through set-asides. As you will note on the attached chart, set-asides are important in every area of Federal procurement.

Once again, Mr. Chairman, I appreciate your holding these hearings today. Your subcommittee is exploring an area of great concern to small business and I hope I have provided you with information which demonstrates the importance of the set-aside program and the rule of two or more. I will be happy to answer any questions you may have.

Small Business Share of Total Sales and Procurement by Major Procurement Group, 1983

Procurement Group	Year	Small Business Share (%)		
		Sales	Procurement	
		(Procurement Weighted)	Total	W/O Set-Asides
All Products	1981	25.54	18.98	11.87
	1982	25.39	18.81	10.43
	1983	24.26	16.44	9.68
Construction	1981	54.56	47.61	21.86
	1982	55.14	52.39	19.66
	1983	56.18	52.17	17.29
Research and Development	1981	18.22	7.25	6.41
	1982	17.99	5.53	4.83
	1983	18.58	5.65	4.88
All Other Services	1981	32.09	24.52	13.82
	1982	33.08	22.94	10.22
	1983	32.67	22.79	11.31
Supplies and Equipment	1981	23.02	16.66	11.34
	1982	22.50	17.86	11.23
	1983	20.29	13.60	9.52

A summary of small business procurement share versus industry share, by major procurement product group is shown above. Note that the small business share of sales is procurement weighted. Procurement weighted sales shares were used because the Federal government does not buy the same mix of goods and services as the economy as a whole. Procurement weighted small business sales shares provide a more appropriate measure of the size makeup of the suppliers of Federal purchasers. Procurement weighted sales shares are calculated by weighting the small business share in each 4-digit SIC by the amount of procurement from the SIC in aggregating the data to industry group totals. The distribution of procurement among SICs is calculated separately for each year and product group.

These data indicate that the percent of goods the Federal government purchases from small businesses does not equal their percentage of the economy for any year or any major procurement group. Performance in research and development is especially poor. In addition, the data indicate the large role played by set-aside awards. Set-aside awards account for almost half of procurement by small business. Their importance is greatest in construction procurement and smallest in research and development procurement.

Jack Faucett Associates, "Procurement Share vs Industry Share," (Washington, D.C.: U.S. Small Business Administration, Office of Advocacy, under award no. SBA-8566-OA-84, September 1985).

Mr. MITCHELL. Thank you, Mr. Swain.

Yes, as usual, you always give a very excellent testimony. It is clear you have done your homework.

I am going to put the question to you very bluntly. In your opinion, is OMB, with respect to the May 22 publication, in violation of the Regulatory Flexibility Act?

Mr. SWAIN. It has not at this point fully complied with the Regulatory Flexibility Act, and, therefore, I will leave it to your wordsmanship. It is in violation. They have plenty of time to cure that violation.

Mr. MITCHELL. It is in violation as of now, in your opinion? I was about to give a little quick course in semantics, but your answer prevented me from doing that.

Now, unfortunately, in our letter to you asking you to testify, we asked you to provide some information. You did not do that in your testimony. We asked you to provide the legal opinion of your office on whether OMB properly invoked its authority under section 6 of the Office of Federal Procurement Policy Act, as amended.

Did it violate that section of the act with its proposed regulatory change of May 22?

Mr. SWAIN. Our opinion is that there is legal authority for the Office of Federal Procurement Policy under section 6 of the OFPP Amendments of 1983 to issue in certain cases Governmentwide procurement directives, but it does not appear from our perspective that they used the right section in this particular case.

They used a section that relates to conflict among the Federal agencies which, of course, from our reading of events, does not exist right here.

Mr. MITCHELL. I guess I understand what you are saying is that in this particular case, it is your opinion that OMB did not act appropriately?

Mr. SWAIN. That is right. I am not saying that in all cases——

Mr. MITCHELL. I understand.

Mr. SWAIN. In the future, OMB—OFPP does not have some sort of general regulatory authority in this area, but it——

Mr. MITCHELL. That is why I emphasize, in this particular case, the action of OMB was not appropriate.

Mr. SWAIN. In our opinion, not according to section 6.

Mr. MITCHELL. Thank you very much.

Congressman Torres.

Mr. TORRES. Just a quick question to our witness.

Based on your testimony and what I have read in your statement, it appears that, in general, you favor the set-aside programs and feel that the Rule of Two has been working. Do you feel that in light of the ambiguity and confusion around this, statutory language would be proper?

Mr. SWAIN. Statutory language on the Rule of Two?

Mr. TORRES. Yes.

Mr. SWAIN. To be honest, Congressman, no. I think procurement is very complicated and if we are guilty of something in the SBA, it is probably not adjusting things enough, and events change and industries change, and I think that statutory language is probably too inflexible, at least from my experience.

Mr. TORRES. Thank you.

I yield back the balance of my time, Mr. Chairman.

Mr. **Mitchell**. Mr. Gallo.

Mr. **Gallo**. Thank you, Mr. Chairman.

Mr. Swain, did you receive anything from OMB in regard to a request for you to review and give an opinion as to their action or pending action?

Mr. **Swain**. Not prior to publication, Mr. Gallo. They forwarded to our office a copy of the publication and their statement under the Regulatory Flexibility Act, but there was not any extensive consultation with the office before they published.

Mr. **Gallo**. Did you react to that publication when you received it?

Mr. **Swain**. Well, this is, in fact, our first formal reaction to the publication. We will be subsequently commenting on the record that the publication states that the record is open for regulatory comments until July 21, and we will be formally commenting probably more extensively than in this testimony to OFPP on the record.

Mr. **Gallo**. Was there any informal comment?

Mr. **Swain**. Well, as previous conversations have stated, the Rule of Two has been a subject of some controversy for several months now. We have commented before on the record. We have had conversations with SBA procurement people, OFPP people, over the last several months, but there was no comment specific to this May 22 notice.

Mr. **Gallo**. Is it your opinion that, obviously, if they continue with this proposed rule that their final interpretation will become binding unless we move legislatively to change it?

Mr. **Swain**. Well, if they are issuing—they are proposing to change the Federal acquisition regulations to go to a different standard, yes, that standard would become binding, unless it were legally inadequate for some reason and it were challenged in court or unless you should, of course, pass a different rule, pass a different law.

Mr. **Gallo**. You are making the assumption that this is not a policy decision, but a legal decision. It would seem to me that their legal decision would be the binding decision on current law.

Mr. **Swain**. Well, they have certainly got—they are the moving force in this particular proceeding and, yes, they are proposing to write a rule. The comment period is open for 2 months. At the end of that 2 months, they can review those comments and say, judging from our analysis of the comments, this is what we propose, this is how we propose to change the regulation and whatever change it is will be effective on such and such a date.

Mr. **Gallo**. With your experience, Mr. Swain, is there any question in your mind that their action does, in fact, have some validity because of the ambiguity of the law?

Mr. **Swain**. The action is not required by the CICA law that was passed in 1984. We are saying that if, as a matter of a general procurement policymaking, they are putting it out under that standard, it may well be legally possible for them to do it, but as a matter of something that is required to comply with the Competition and Contracting Act, we do not think that is the case, and, of course, on substance, we do not think it is required either because the system is working pretty well now.

Mr. GALLO. In other words, you do not think that there is a need for legislative action to clear up the intent?

Mr. SWAIN. Well, I guess my reaction would be let us wait and see what happens at the end of the comment period. If the Congress does not like what the final decision is, then there may be some need for legislative action, but I would prefer to let the discussion period continue.

Mr. GALLO. Thank you for your candor, Mr. Swain.

Mr. MITCHELL. Congressman Hayes.

Mr. HAYES. Thank you, Mr. Chairman.

Just one question. I know it may be somewhat redundant.

As Chief Counsel for Advocacy for the Small Business Administration, Mr. Swain, I know you have some influence on policy in that department, but you do not make it. I am not accusing you of making it. I was wondering if there is a small trickle of human kindness flowing through your veins as to the retention of the set-aside program.

Mr. SWAIN. Well, I would say it is more than a—put in those words, Congressman, it is more than a small trickle; maybe a gushing vein or something. I am not sure.

We are very strongly in support of the set-aside program, and I think that you could probably take a poll of this room and everybody that was a Government witness would say that they are pretty strongly in support of the set-aside program.

Of course, the key question that the chairman has raised in these hearings is, well, having said all that, how does it work and what is the best way for it to work? We think it works pretty well right now. A little fine-tuning here and there is always appropriate, but we think it works pretty well right now, and we support it.

Mr. HAYES. Is that what the acting director is doing, fine-tuning it?

Mr. SWAIN. Well, now, I believe that when the official agency statement is received from Mr. Heatherly, that, in substance, it will strongly support the set-aside program. I have no reason to doubt that.

Mr. HAYES. Thank you, Mr. Chairman.

Mr. MITCHELL. Congressman Dreier.

Mr. DREIER. Thank you, Mr. Chairman.

In response to Mr. Hayes' question, I think that is part of the proposal that I have offered and the administration has offered, too, in the budget process and the legislation I have introduced.

I wanted to get to the size standards question. We have been hearing, Frank, for years and years that major revisions have been coming down the line for size standard reform, and then, when this committee was considering it, we saw opposition from the SBA, and I am just wondering if there really is an effort within the Small Business Administration to bring about true small business size standard reforms to rectify the inequities that exist.

Mr. SWAIN. I think, Mr. Dreier, I have sat as a nonvoting member of the so-called size standards policy board for the last couple of years. I guess I would like to reiterate the substance of what Mr. Motley said about that.

The size standard area is the single stickiest area that I have seen in the SBA. It is tougher to change a size standard than it is to figure out who gets a loan or who does not get a loan because it is, by definition, an ox-goring issue.

You are going to draw the line somewhere different and some different people are going to be above the line and some different people are going to be below the line.

We have a size standard that I think may even be tied up in litigation on dredging. A number of the people on this committee are familiar with it. We have letters with a couple of dozen Senators and Congressmen on one side and a couple of dozen Senators and Congressmen on the other, and some businesses on one side and some businesses on the other.

We cannot get that damn standard changed, although I would like to, personally. We would like to say that we are in favor of overall change, but every time we start to change it overall, we, all of a sudden, have to start on one at a time and every one of those calls is a tough call.

Mr. DREIER. OK. So, based on that then, what would your projection be? As I said, I have been hearing for a long time that there will be an overall change. So, if that kind of opposition on both sides continues, then are you saying that there will not be major change?

Mr. SWAIN. I think that every change that has been made in the last couple of years at the agency has been to lower the size standards that have been particularly discussed, and I think that is generally the trend at the agency as these issues come up. But broad, wholesale, sweeping reform, I do not think is in the cards.

Mr. DREIER. Thanks, Mr. Chairman.

Mr. MITCHELL. Thank you.

Congressman Ireland.

Mr. IRELAND. Thank you, Mr. Chairman.

Mr. Swain, the counsel for the Office of Management and Budget is going to respond to questions about regulatory flexibility.

I would like to give you, from testimony, the first reason and ask you for your comment. They say:

> The proposed rule is an executive branch procurement regulation, which establishes internal procurement procedures and imposes no regulatory burden upon small entities.

Could you respond?

Mr. SWAIN. Well, my view, Mr. Ireland, is that the Regulatory Flexibility Act, as you very well know, is written in some very broad terms, and the responsibility to do an analysis is not triggered only when there is a direct regulatory burden on small businesses.

But, the key word is that the responsibility to do an analysis and to take a look at lesser standards of regulation is that when there is a significant economic effect on a substantial number of small businesses, we, as I stated previously, think that common sense leads one to believe that there may, indeed, be a significant economic effect, that people may argue a whole lot as to how significant it is, but we think some analysis of what it is is called for.

Mr. IRELAND. One of the other arguments that crops up is that the effect is not much because the effect pertains only to a small number of all small business.

In this case, the universe would be only those that would have any likelihood of doing business with the Government. Therefore, the effect is negligible.

Do you run into this kind of argument frequently?

Mr. SWAIN. Well, we do, from time to time, but not usually in numbers that would be—for instance, I am sure that the witnesses from the buying agencies could easily tell you how many different businesses they deal with in procurement that are small in a given year, and I would—if the Government as a whole is buying $30 billion worth of goods and services from small business and half of that is in set-asides, we are talking about tens of thousands, hundreds of thousands of small businesses.

So, the threshold of significance, I think, is not a difficult one to get over. There are going to be a lot of businesses that are affected by set-aside policy. Now, the question here is really not how many would be affected by set-aside policy, but how many of these businesses would not become vendors or would not be turned to by the agencies because the agencies would have a tougher call at the GS-9, 10, 11, 12 level, those contracting officers all of a sudden have to make a tougher judgment about using some mercurial language than just the Rule of Two.

I think that is a question that the buying agencies can supply a lot of information about what we are not really expert on, but somebody ought to take a look at that.

Mr. IRELAND. One final question.

Do I understand that you plan to file comments on this?

Mr. SWAIN. Yes. Absolutely.

Mr. IRELAND. Thank you, Mr. Chairman.

Mr. MITCHELL. All right. I will have to announce now that we do have a vote. I assume it is an amendment to one of the amendments to the housing bill. We have 15 minutes in which to vote. Let us run over and vote and come back as promptly as we can.

I was thinking about a platooning system, but maybe we had better not try that.

Mr. Swain, thank you very much for your testimony.

Mr. SWAIN. Thank you, Mr. Chairman.

Mr. MITCHELL. As soon as we return, we will start with panel 3.

[Recess.]

Mr. MITCHELL. Our hearing will now resume.

Panel 3 consists of Ms. Norma Leftwich, the director of the Office of Small and Disadvantaged Business Utilization in the Department of Defense, and her people; Adm. Stuart J. Evans, the assistant administrator for procurement in the National Aeronautics and Space Administration; and Patricia Szervo, associate administrator for acquisition policy in the General Services Administration.

This is really a unique and historic occasion when DOD, NASA, and GSA, despite the existence of a directive from OMB, choose to do the right thing.

All of you, as I understand it, informed OMB of your strong belief that the Rule of Two does not violate CICA.

All of you are to be commended, not only for the fairness of your legal opinion, but for your willingness to stand up for it.

In my years in Congress, I have always been amazed at the Federal agency people who very strongly take a position pro or con, but when the time comes to stand up and testify, they vacillate. I do commend you for not doing that.

I do not generally give praise like this, but in my closing months in the Congress, it is encouraging to see that kind of integrity being demonstrated by the various agencies involved here this morning.

Our leadoff witness is Ms. Norma Leftwich.

TESTIMONY OF NORMA B. LEFTWICH, DIRECTOR, OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION, DEPARTMENT OF DEFENSE, ACCOMPANIED BY DENNIS TROSCH, ASSISTANT GENERAL COUNSEL, LOGISTICS; AND ELEANOR R. SPECTOR, DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR PROCUREMENT

Ms. LEFTWICH. Thank you, Mr. Chairman.

Mr. MITCHELL. Again, I would urge that you try to summarize your testimony because many of the members will be leaving. We still have legislation on the floor and all other kinds of problems. Ms. Leftwich.

Ms. LEFTWICH. All right. I will get straight to the point, Mr. Chairman.

With me today are Eleanor Spector, deputy assistant secretary for procurement, and Dennis Trosch, assistant general counsel for logistics.

The Department of Defense [DOD] has been a strong proponent of small business programs because of our belief that small business is a critical part of this country's industrial base, and therefore important to the DOD. As such, we have taken many steps to strengthen our small business programs over the years, not the least of which was to quantify the sufficiency of competition to initiate a small business set-aside. This resulted in the so-called Rule of Two or More being established in what was the Defense Acquisition Regulation in 1979. The DOD-wide implementation followed the Navy's lead which had used this criteria since 1963. Let me now address the specific issues and questions raised in your invitation to testify.

At the outset, I would like to respond to your apparent concern with respect to the rationale of the Department of Defense for declining to publish for comment the change proposed by the Office of Federal Procurement Policy. We anticipated the publication would bring us a substantial number of comments concerning the need for and merits of the change. In view of the fact that OFPP, not DOD, is the proponent for the proposed change, we concluded that OFPP was in the best position to assess and respond to those comments.

Under the circumstances, it would serve no purpose for DOD to act as a collection point for comment.

Now, let me go on to your specific questions.

Is it the legal opinion of your department that CICA requires the repeal of the Rule of Two? We are of the opinion that the Competition and Contracting Act does not require the repeal of the Rule of Two. DOD has awarded a substantial number of contracts under the authority of the Competition and Contracting Act utilizing the Rule of Two. It is our legal opinion that those contracts following that procedure were awarded legally and are legal contracts. The Rule of Two provides the threshold on which to base the decision to set aside a procurement for exclusive participation by small businesses. The rule in no way limits full and open competition within the set-aside.

Is it the legal opinion of your department that OFPP properly invoked its authority pursuant to section 6 of the OFPP Policy Act to justify its May 22 publication? DOD takes no issue procedurally with publication by OFPP of the proposed change, and, in fact, advised them by letter, dated March 26, that we preferred that they publish the policy directly. Section 6 of the OFPP Policy Act authorizes the administrator to prescribe Governmentwide procurement policies, which shall be implemented in the single system of Governmentwide procurement regulations, and to prescribe Governmentwide regulations when DOD, NASA, and GSA, are unable to agree on or fail to issue those regulations in a timely manner. Opinions may differ as to whether DOD, NASA, and GSA have formally reached the point of being unable to agree. However, the administrator of OFPP does have adequate authority under section 6 to prescribe a change in the Rule of Two.

Would adoption of the proposed regulation be likely to address the effect, the share of the prime contract dollars awarded to small concerns? For each of the last 15 years, what share of the prime contract dollar was awarded to small business and what percent was awarded through the small business set-aside program?

The statistical information you requested can be found at attachment A of this testimony. As to the first part of the question, it is certainly difficult, if not impossible, to quantify with any preciseness what might be lost in small business awards with a change in the regulation. We know for instance that there has been an increase in set-asides from 7 percent in 1979 to 10 percent in 1985. We also know that in 1985 set-asides accounted for 53.7 percent of our total awards to small business. Clearly the Rule of Two or More has provided for consistency throughout the DOD in determining when to initiate a set-aside. We are also concerned that the "lowest reasonably cost" criteria which is a part of the proposed regulation would be an extremely difficult criteria for the contracting officer to reasonably foresee and would therefore possibly become an additional disincentive to initiating a set-aside.

Also attach to your statement a copy of any and all correspondence by and between your Department and OMB or OFPP relating to the Rule of Two and the effect of CICA on that regulation.

This correspondence can be found at attachment B.

We have included all of the correspondence that you have requested and it is a part of our statement, sir.

Thank you.

[Correspondence referred to above follows:]

Small Business and Set-Aside Awards
($ = ~~Thousands~~) Millions

	Total Awds	SB Awds	SB %	SA Awds	% to Tot Awds	SA Awds to SB Awds
1970	$ 31,777	$ 5,492	17.3	$ 1,533	4.8	27.9
1971	31,063	5,292	17.0	1,589	5.1	30.0
1972	34,047	6,128	18.0	1,752	5.1	28.6
1973	32,479	6,672	20.5	1.890	5.8	28.3
1974	34,519	7,074	20.5	1,817	5.3	25.7
1975	38,207	7,895	20.7	2,251	5.9	28.5
1976	38,998	8,108	20.8	2,291	5.9	28.3
1977	47,114	9,535	20.2	2,898	6.1	30.3
1978	54,358	10,735	19.7	3,434	6.3	32.0
1979	58,544	12,171	20.8	4,105	7.0	32.7
1980	66,704	13,589	20.4	4,787	7.2	35.2
1981	87,195	17,770	20.4	8,321	9.5	46.8
1982	102,463	20,143	19.7	10,041	9.8	49.8
1983	121,096	22,769	18.8	11,711	9.7	51.4
1984	124,912	23,817	19.1	12,448	10.0	52.3
1985	139,587	26,049	18.7	13,980	10.0	53.7

THE SECRETARY OF DEFENSE
WASHINGTON, THE DISTRICT OF COLUMBIA

ATTACHMENT B

6 APR 1986

Honorable James C. Miller, III
Director, Office of Management
  and Budget
Washington, D.C. 20503

Dear Jim:

I am concerned about the consequences of a change to the threshold for small business set-asides that the Office of Federal Procurement Policy (OFPP) proposes to make in the Federal Acquisition Regulation.

The Department of Defense operates a significant small business program, not only because of the statutory provisions concerning small business, but because of the vital role played by small business in our defense industrial base. Key to the success of this effort are small business set-asides. The Federal Acquisition Regulation now permits such a set aside if the competitive base consists of two or more responsible small business concerns and the contracting officer determines that awards will be at reasonable prices. OFPP proposes to eliminate this "rule of two or more," and substitute as the numerical trigger for such set-asides the indefinite standard that there must be a "sufficient number of small business concerns" to fulfill the government's requirements at the "lowest reasonable cost." These criteria, coupled with the determinations required of the contracting officer, are likely to significantly impair the ability to make set-asides.

Congress has established the policy of ensuring that a fair share of our contracts are awarded to small business firms. The Small Business Act also provides for the Administrator of the Small Business Administration to establish annual goals for each Department to attain in awarding contracts to small business concerns. The only way a purchasing activity can assure that small business concerns receive any awards is through the set aside procedures. The "rule of two or more" provides an effective means for determining when a particular award should be set aside for small business. Specifing a definite number of bids as a set aside trigger is far more effective than an indefinite standard such as a "sufficient number."

The issue therefore comes down to a simple one. If purchasing agencies are to have the responsibility for assuring that a proportion of their awards go to small business with the attendant goals and evaluations of performance against the goals, then a set aside program coupled with a workable triggering device such as the "rule of two or more" is the only way of assuring that sizeable small business goals will be met. The "rule of two or more" can be eliminated or a less effective triggering device substituted only if at the same time the purchasing agencies are relieved of the responsibility of assuring that a proportion of their awards will go to small business. The "rule of two or more" issue cannot be decided without deciding the real effect of such a decision. To ignore the effect would mean that year after year the purchasing agencies would be excoriated before Congressional committees and in other fora for failing to meet small business goals. There would be further erosion in confidence in the government's purchasing system and continued dissention between the small business committees in Congress and the executive branch.

Accordingly, I would appreciate your taking a personal interest in this issue, and that the OFPP reconsider the directive regarding the "rule of two or more."

Sincerely,

NINETY-EIGHTH CONGRESS
Congreſs of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, D.C. 20515

MAR 16 S
E UNIT

March 14, 1984

The Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Dave:

It has come to my attention that the Federal Acquisition Regulation (F which is to become effective on April 1, 1984, contains provisions which require that all Federal procurements be set aside exclusively for small business participation if there are two small business concerns available to meet the government's requirements. These provisions violate current la and create a serious restriction on the government's ability to obtain gooc and services from the maximum practicable number of vendors at the lowest c

While I support efforts to open up the Federal marketplace to small business, I strongly oppose these provisions. It is inherently unfair to tu over the Federal marketplace to any single economic group. The major purpos of procurement is to serve agency missions in a cost-effective manner. If w sacrifice this principle in order to achieve other goals, it will not only substantially increase costs, but may do untold harm to agency missions.

It is my understanding that the "rule of two" set aside provisions were not included in the version of the FAR that went out for public comment. I would appreciate an explanation of how they came to be included in the regu and at whose request. In any case, I recommend that you take action to remc these provisions before they become effective on April 1.

With best wishes, I am

Sincerely,

Jack Brooks

JACK BROOKS
Chairman

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. [illegible]

APR 5 1984

MEMORANDUM TO: MARY ANN GILLEECE, DOD
ALLAN BERES, GSA
STU EVANS, NASA

FROM: DAVID A. STOCKMAN

SUBJECT: Response to Congressman Brooks

The attached letter from Congressman Brooks raises questions regarding the "rule of two" small business set-aside provisions in FAR 19.502-2. Please provide information on which to base a response to Mr. Brooks.

It is our view that, while the receipt of responsive offers from two responsible offerors has long been acceptable as evidence of adequate price competition for purposes of complying with P.L. 87-653, it is quite another matter to adopt a standard which limits the competitive field based on the presumption or possibility of competition but which in fact may not ensure either competition or reasonable prices. This appears to have been caused by confusion over the distinction between "competition" as an end result and "competitive procedures."

We would appreciate your response, including your position on changing FAR 19.502-2, by April 13, 1984.

OFFICE OF THE UNDER SECRETARY OF DEFENSE
WASHINGTON, DC 20301

18 APR 1984

RESEARCH AND
ENGINEERING

(AM)

Honorable David A. Stockman
Director
Office of Management and Budget
Washington, DC 20530

Dear Mr. Stockman:

This is in reply to your memorandum of April 5, 1984, referencing Congressman Brooks' letter and requesting information on the "rule of two or more" set-aside provision in subsection 19.502-2 of the Federal Acquisition Regulation (FAR). According to Mr. Brooks, the cited passage contains policies which require that all Federal procurements be set aside exculsively for small business participation if there are two small business concerns available to meet the Government's requirements.

To accomplish the purpose of the Small Business Act, Congress authorized the use of a set-aside procurement method for any contract (or part of a contract) whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns..." It should be noted that the first two justifications deal with benefits that accrue not to the small business community but rather to the Government. (underscoring added.)

The only mechanism available to carry out this Congressional mandate is through the small business set-aside program, which serves as the under pinning of the Federal agencies small business programs.

FAR subsection 19.502-2 represents our best efforts to comply with the direction of Congress to support the small business community. Our procurement regulations established procedures for both total and partial small business set-aside programs (FPR 1-1.706; DAR 1-706; NASA PR 1.706). These have worked effectively for almost thirty years to enhance the opportunities for small business and small disadvantaged business firms to participate in the acquisition of products and services by Federal agencies.

Current FAR coverage gives the Executive Agencies a precise formula for deciding when to use a small business set-aside. Until the procurement regulations were amended to include the "rule of two or more," the only measure for deciding to make a small business set-aside was whether there was "a reasonable expectation" that a "sufficient number" of responsible small business firms would submit offers "at reasonable prices." This standard was open to broad interpretation and proved inadequate; there was inconsistency of application from one contracting office to another within any given agency and certainly across the Federal Government.

The initial version of the FAR (Phase I) circulated for comment did not relect the "rule of two or more" because it was based on the Federal Procurement Regulation (FPR) that enunciated only the "sufficient number" criterion. Virtually all the public comments received on FAR 19.502-2 (including those of DoD, GSA, NASA, and SBA) requested it be amended to include the "rule of two or more." There were two main concerns reflected in the commentors' remarks. The "rule of two or more" is required to be followed in placing small purchases in accordance with P.L. 95-507. It is logical to follow that policy for other procurements if procuring agencies are to accomplish the mandate of the Armed Services Procuement Act of 1947, the Federal Property and Administrative Services Act of 1949, and the Small Business Act; i.e., to ensure that small businesses receive a fair share of the total of Federal contracts. Secondly, the old "sufficient number" standard is difficult to interpret, leaving the decision to thousands of buyers and contracting officers throughout the entire Federal establishment. This produces confusion not only for procurement personnel but also for the Small Business Administration and for the thousands of small business and small disadvantaged business firms throughout the country.

Our surveillance reviews showed that in numerous cases some contracting officers did not set aside a procurement for small business when their bidder's mailing lists contained in excess 15-20 small firms which had registered a capability to provide a required productor service. For example, this situation resulted in DoD's set-asides averaging only approximately 6% of its annual expenditures with U.S. business firms. Within the Department of Defense, the Navy Department had established the "rule of two or more" in their Navy Procurement Regulations (NPR) in 1964. The Federal agencies record awards as being competitive whenever offers are received from two or more business firms. This, in the main, established that the test of sufficiency of competition to set-aside a procurement for exclusive participation by small business firms is satified when there is reasonable expectation that offers will be received from two or more small business firms. We do not believe we can have one standard for measuring competition in the procurement awards made and a different standard as to what constitutes competition for a small business set-aside.

Codification of such sufficiency of competition was included in the DAR on July 27, 1978 and has contributed to increasing the rate of set-asides merely to 9.7% in FY 1983 ($109.8 billion or 90.3% of DoD's total awards of $121.1 billion were made by other than small business set-aside).

It should be noted that DoD alone processed 14.8 million procurement actions during FY 1983. The majority of these actions were processed by automated procurement systems. In the design of such systems the old approach of using the term "sufficient" could not be used, quantification was and is mandatory. It should also be noted, there have been several Comptroller General cases which have substantiated the legality of this policy.

We would like to note that small business set-asides generally result in more, not less competition. This increase in competition results because of two factors: There are a much greater number of small business firms than big business firms; secondly, the small business community perceives that when a procurement is set-aside, it, by definition, can not be a sole source award and that they will be competing against their peers and therefore stand a realistic chance of winning the contract.

The practice of setting aside procurements for small businesses has long been accepted as Congressional policy and that of past and present Administrations. Thus, the FAR merely continues a long-standing practice of partial and total set-asides. However, the FAR settled on language that was consistent with the DAR and NASA Procurement Regulations to eliminate the problem being experienced under the Federal Procurement Regulations (FPR) as to how many firms constituted a "sufficient number" to warrant a set aside. Therefore, the current FAR language only represents new policy for former FPR users of the Federal civilian agencies other than NASA. It reflects a policy that has been in effect for over 20 years in the Navy, almost five years DoD-wide and approximately one and one-half years at NASA.

The published version of the FAR reflects the negotiated agreement between the three procurement regulatory agencies, (DoD, GSA, and NASA) to arrive at a workable standard for small business set-asides in order to provide for the required consistency of application needed across the Federal government. We do not view the FAR language as permitting one economic group to take over the Federal market place. Small business set-asides are used to attain the small business participation goals set pursuant to Public Law 95-507 (15 U.S. 644), and not to deprive large business of its share or to unduly limit the competitive field. We do not feel that the FAR language violates current law but rather that it reflects the will of Congress as expressed in the Small Business Act.

In summary, FAR 19.502-2 was written to conform to the public comments received when the first version of the FAR was circulated and, as previously stated, is in furtherance of the mandate to ensure that small business receive a fair proportion of Government contract awards. In view of this, we see no valid reason to change the FAR language.

Sincerely,

HARVEY J. GORDON
Signed ACTING DEPUTY UNDER SECRETARY
(ACQUISITION MANAGEMENT)

Mary Ann Gilleece
Deputy Under Secretary of Defense
(Acquisition Management)
Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON DC 20301-3061

RESEARCH AND
ENGINEERING
(AM)

31 DEC 1984

Mr. William Maraist
Office of Federal Procurement Policy
Office of Management and Budget
726 Jackson Place
Washington, D.C. 20503

Dear Mr. Maraist:

The following is submitted on behalf of the Department of Defense in response to your Federal Register Notice Vol. 49, No. 199 of October 12, 1984 seeking comments on the "rule of two or more."

To accomplish the purpose of the Small Business Act, Congress authorized the use of a set-aside procurement method for any contract (or part of a contract) whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns..." It should be noted that the first two justifications deal with benefits that accrue not to the small business community but rather to the Government (underscoring added.)

The only mechanism available to carry out this Congressional mandate is through the small business set-aside program, which serves as the underpinning of the Federal agencies' small business programs.

FAR subsection 19.502-2 represents our best efforts to comply with the direction of Congress to support the small business community. Our procurement regulations establish procedures for both total and partial small business set-aside programs (FPR 1-1.706; DAR 1-706; NASA PR 1.706). These have worked effectively for almost thirty years to enhance the opportunities for small business and small disadvantaged business firms to participate in the acquisition of products and services by Federal agencies.

Current FAR coverage at 19.502-2 gives the Executive Agencies a precise formula for deciding when to use a small business set-aside. Until the procurement regulations were amended to include the "rule of two or more," as a firm standard, the only measure for deciding to make a small business set-aside was whether there was "a reasonable expectation" that a "sufficient number" of responsible small business firms would submit offers "at reasonable prices." The "sufficient number" standard was open to broad interpretation and proved inadequate; there was inconsistency of application from one contracting office to another within any given agency and certainly across the Federal Government.

The initial version of the FAR (Phase I) circulated for comment did not reflect the "rule of two or more" because it was based on the Federal Procurement Regulation (FPR) that enunciated only the "sufficient number" criterion. Virtually all the public comments received on FAR 19.502-2 (including those of DoD, GSA, NASA, and SBA) requested it be amended to include the "rule of two or more." There were two main concerns reflected in the commentors' remarks. The "rule of two or more" is required to be followed in placing small purchases in accordance with P.L. 95-507. It is logical to follow that policy for other procurements if procuring agencies are to accomplish the mandate of the Armed Services Procurement Act of 1947, the Federal Property and Administrative Services Act of 1949, the Competition in Contracting Act of 1984, and the Small Business Act; i.e., to ensure that small businesses receive a fair share of the total of Federal contracts. Secondly, the old "sufficient number" standard is difficult to interpret, leaving the decision to thousands of buyers and contracting officers throughout the entire Federal establishment. This produces confusion not only for procurement personnel but also for the Small Business Administration and for the thousands of small business and small disadvantaged business firms throughout the country which support the various procuring agencies of the Federal establishments. This confusion resulted from the lack of knowledge and consistency of application as to what was the precise quantification of the sufficiency of expected responses from the small business community to justify the setting aside of a procurement for exclusive participation by small business firms.

Our surveillance reviews showed that in numerous cases contracting officers did not set aside a procurement for small business when their bidder's mailing lists contained in excess of 15-20 small firms that had registered a capability to provide a required product or service. For example, this

situation resulted in DoD's set-asides averaging only approximately 6% of its annual expenditures with U.S. business firms. Within the Department of Defense, the Navy Department had established the "rule of two or more" in their Navy Procurement Regulations (NPR) in 1964. With the passage of the Amendment to the Small Business Act (Public Law 95-507) and the requirement to revise the Defense Acquisition Regulation (DAR) to include the provisions of this amendment, the DoD reviewed the Navy's rule of two or more for DoD-wide application and codification in the DAR. This review indicated that competition is binary, - it exists or it does not, - or more specifically, a solicitation/contract award is either sole source or it's competitive. DoD, like other Federal agencies, records awards as being competitive whenever offers are received from two or more business firms. Accordingly, the test of sufficiency of competition to set-aside a procurement for exclusive participation by small business firms is satified when there is reasonable expectation that offers will be received from two or more small business firms. We do not believe we should have one standard for measuring competition for non-small business set-asides and a different standard as to what constitutes competition necessary for a small business set-aside.

Codification of such sufficiency of competition was included in the DAR on July 27, 1978 and has contributed to increasing the rate of set-asides to only 10.0% in FY 1984 ($112.5 billion or 90.0% of DoD's total awards of $124.9 billion were made by other than small business set-aside).

It should be noted that DoD alone processed 14.8 million procurement actions during FY 1984. The majority of these actions were processed by automated procurement systems. In the design of such systems the old approach of using the term "sufficient" could not be used, quantification was and is mandatory in the establishment and operation of these automated procurement ordering and reporting systems.

We would like to note that small business set-asides generally result in more, not less competition. This increase in competition results because of two factors: (1) there is a much larger number of small business firms than big business firms; (2) the small business community perceives that when a procurement is set-aside, it, by definition, can not be a sole source award and that they will be competing against their peers and therefore stand a realistic chance of winning the contract.

The practice of setting aside procurements for small businesses has long been accepted as Congressional policy and that of past and present Administrations. It should also be noted, there have been several Comptroller General cases which have substantiated the legality of this policy. Thus, the FAR merely continues a long-standing practice of partial and total set-asides. However, the FAR settled on language that was consistent with the DAR and NASA Procurement Regulations to eliminate the problem being experienced under the Federal Procurement Regulations (FPR) as to how many firms constituted a "sufficient number" to warrant a set aside. Therefore, the current FAR language only represents new policy for former FPR users of the Federal civilian agencies other than NASA. It reflects a policy that has been in effect for over 20 years in the Navy, almost five years DoD-wide and approximately one and one-half years at NASA.

The published version of the FAR reflects the negotiated agreement between the three procurement regulatory agencies, (DoD, GSA, and NASA) to arrive at a workable standard for small business set-asides in order to provide for the required consistency of application needed across the Federal government. We do not view the FAR language as permitting one economic group to take over the Federal market place. Small business set asides are used to attain the small business participation goals set pursuant to Public Law 95-507 (15 U.S. 644), and not to deprive large business of its share or to unduly limit the competitive field. We do not feel that the FAR language violates current law but rather that it reflects the will of Congress as expressed in the Small Business Act.

In summary, FAR 19.502-2 was written to conform to the public comments received when the first version of the FAR was circulated and, as previously stated, is in furtherance of the mandate to ensure that small business receive a fair proportion of Government contract awards. In view of this, we see no valid reason to change the FAR language.

Sincerely,

Eleanor Spector

ELEANOR R. SPECTOR
ACTING DEPUTY UNDER SECRETARY
(ACQUISITION MANAGEMENT)

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

Federal Acquisition Regulation (FAR) "Rule of Two"; Requirements for Setting Aside Acquisitions for Small Business

AGENCY: Office of Management and Budget.

ACTION: Notice of comment.

SUMMARY: The purpose of this notice is to solicit the views of all interested parties in both the public and private sector on the "rule of two" in Part 19 of the Federal Acquisition Regulation (FAR).

DATE: Comments are due on or before November 30, 1984.

FOR FURTHER INFORMATION CONTACT: William Maraist, Office of Federal Procurement Policy, OMB, (202–395–3300).

SUPPLEMENTARY INFORMATION: Although not new, the so called "rule of two" in FAR Part 19 has generated considerable controversy. The primary criticism is that this provision of the regulation did not receive adequate public notice and availability for comment.

The "rule of two" appears in FAR 19.502 which provides the requirements for setting aside acquisitions for small business:

"19.502 Setting aside acquisitions.

"19.502–1 Requirements for setting aside acquisitions.

Using the order of precedence in 19.504, the contracting officer shall set aside an individual acquisition or class of acquisitions when it is determined to be in the interest of (a) maintaining or mobilizing the Nation's full productive capacity, (b) war or national defense programs, or (c) assuring that a fair proportion of Government contracts is placed with small business concerns, and when the circumstances described in 19.502–2 or 19.502–3(a) exist.

"19.502–2 Total set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business—small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502–3 as a partial set-aside). Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

As shown above, the "rule of two" is part of the standard of competitiveness required before an acquisition may be set aside for small business—"a reasonable expectation that offers will be obtained from at least two responsible small business concerns * * * and awards will be made at reasonable prices." This standard was contained in the Defense Acquisition Regulation (DAR) and the NASA Procurement Regulation prior to the publication of the FAR. The Federal Procurement Regulations (FPR) coverage on set-asides, on the other hand, included a "sufficient number" standard. The FAR is essentially a consolidation of these two primary regulations. The drafters displayed the DAR and FPR coverages in side-by-side columns, and the proposed FAR coverage in a third column. These drafts were then made available for public comment. In the case of the set-aside provisions in question, the "sufficient number" standard was initially proposed for the FAR. Five of the six comments (including those of DOD, GSA, NASA and SBA) received on this provision requested that the language be amended to include the more specific criteria contained in the DAR (i.e., two or more) for determining if small business competition is available. The sixth comment requested added language to the effect that the set-aside would not impair agency mission or program requirements. Because contracting officers in the civil agencies had not consistently applied the "sufficient number" standard, and because the "rule of two" had worked well in DOD for more than five years as well as in NASA, the three regulatory agencies decided, in the final review phase, that the most workable standard for total set-asides was the "rule of two." "Sufficient number" as a standard provides little or no substantive guidance.

One of the issues raised by those who have criticized the "rule of two" is that in certain industries or product lines a disproportionate share of the Government's business is set-aside for exclusive participation by small businesses. However, this does not result from the "rule of two." The key to this issue is in the Small Business Act (15 U.S.C. 644) requirement that "* * * a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns * * *". Fair proportion is tied in the statute to *total* purchases and contracts made by the Government. The bulk of Federal expenditures are for major systems which, at the prime contract level, are unavailable to small business. Therefore, ensuring that small business receives a fair proportion of the *total* Government contracts practically dictates that a disproportionate share must be awarded to small business outside of the major systems area.

This is to be expected when there are *many* small businesses in a given industry sector. The experience of the major procuring agencies indicates that the result would not change, even if "sufficient number" or some other standard were substituted for the "rule of two." The agencies report substantial competition in the small business set-aside program with an average of ten or more competitors on each procurement. Therefore, the issue is not the method of determining whether there is adequate competition among small businesses. Rather, it appears to be whether the situation should be allowed to continue which results in such disproportionate shares of Federal requirements for particular products or services being set-aside for small business?

We believe that the FAR language complies with current law and reflects the will of the Congress as expressed in the Small Business Act. This method of implementing the fair proportion of *total* contracts has been upheld by the Courts and the Comptroller General.

Comments

All interested parties are invited to comment on the issue of the most appropriate standard for determining competitiveness in making a small business set-aside determination (e.g., rule of two, sufficient number, other standard). Comments should not be sent on the related issue of setting small business size standards. Small business size standards are set by the Small Business Administration and do not fall within the procurement policy authority of the Administrator for Federal Procurement Policy. Comments should be forwarded to William Maraist, Office of Federal Procurement Policy, OMB, 726 Jackson Place, Washington, DC 20503 on or before November 30, 1984. Mr. Maraist may be contacted by phone at 202–395–3300.

Dated: October 2, 1984.

Donald E. Sowle,

Administrator.

[FR Doc. [illegible] Filed [illegible]]

BILLING CODE 3110-01-M

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND
LOGISTICS

26 MAR 1986

Mr. David F. Baker
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Room 9001
New Executive Office Building
Washington, DC 20503

Dear Mr. Baker:

In response to your request, this confirms my telephone call to you on March 21, 1986, regarding publishing your proposed change to the "rule of two" in the Federal Register. As I stated, we are concerned about Office of Federal Procurement Policy (OPFF) not following the agreement that we had worked out as set forth in OFPP policy letter 85-1 dated August 19, 1985.

However, this is not the underlying reason for my statement to you that we prefer OFPP publish the proposed change to the "rule of two." It is clear that the proposed change will be controversial. Were we to publish the change, we anticipate receiving a number of objections and requests for justification for the change from small business supporters in the Congress. After discussing this with my colleagues in GSA and NASA, we concluded that, since you have been the proponent of the change, it would be preferable for you to publish the policy directly. Of course we would assist you in this where we could.

Sincerely,

Eleanor Spector

Eleanor R. Spector
Deputy Assistant Secretary of
Defense for Procurement

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAY 07 1986

Honorable Caspar W. Weinberger
Secretary of Defense
Washington, DC 20301

Dear Cap:

Thank you for your letter of April 6, 1986 regarding the direction from the Office of Federal Procurement Policy, dated February 21, 1986 to implement certain provisions of the Competition in Contracting Act of 1984.

I understand your concern that this statutory change may appear to hamper the small business set-aside program. However, as representatives of the Department of Defense have stated many times in discussing this issue, the small business industry is very competitive and it is rare that there would be only two small business offerors on a particular procurement. We, therefore, cannot agree, as stated in your letter, that the rule of two standard "... is the only way of assuring that sizeable small business goals will be met." Nor can we agree that the rule of two can be eliminated "...only if, at the same time, the purchasing agencies are relieved of the responsibility of assuring that a proportion of their awards will go to small business." (Emphasis added)

This Administration supports the Small Business Act requirement that a fair proportion of Federal procurement be awarded to small business. The "sufficient number" standard, required by the Competition in Contracting Act, was, at one time, used by all agencies including the Department of Defense. It was also successfully employed by the civil agencies up until the effective date of the Federal Acquisition Regulation. We, therefore, do not believe that a return to this standard will preclude successful implementation of the Small Business Act especially in light of the fact that all agencies have upgraded the quality of their procurement personnel who should be able to make more professional decisions that are not just determined by a simple rule.

It is also very important to note that the cognizant Subcommittee Chairman and ranking minority member of the Senate Governmental Affairs Committee, the Chairman and ranking minority member of the House Government Operations Committee, and the Chairman and ranking minority member of the House Appropriations Subcommittee on Military Construction have advised this Office that the changes are necessary to properly implement provisions of the Competition in Contracting Act and we should comply with Congressional intent. We should not continue to ignore this strong and direct communication from the Congress.

We recognize and applaud the significant contributions made by the Defense Department in advancing the interests of small business. We will also appreciate your continued cooperation and leadership in the implementation of the Competition in Contracting Act.

Sincerely yours,

Joseph R. Wright, Jr.
Deputy Director

Mr. MITCHELL. Thank you very much.

I would like to hear from all three witnesses and then we will put questions.

Admiral.

TESTIMONY OF ADM. STUART J. EVANS, ASSISTANT ADMINISTRATOR FOR PROCUREMENT, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

Admiral EVANS. Thank you, Mr. Chairman.

Consistent with your request, I will summarize my statement, since I know it is long.

Mr. MITCHELL. I appreciate that very much.

Admiral EVANS. I appreciate the opportunity to be here today in response to your invitation on May 27.

In that invitation, you asked us to address several questions, and while I did in my prepared statement in some detail, I will summarize rather briefly here.

With respect to the first question you posed to us, the Rule of Two and its consistency with CICA, we at NASA have consistently and repetitively taken the position that the Rule of Two is wholly consistent with CICA. We have also opposed the substitution of what I would view as a vague, undefined and somewhat confusing standard.

We first took this position in a letter to OMB on April 17, 1984. I took the same position in a meeting with the then OMB counsel, approximately a year ago.

We jointly, that is, my colleagues at the table here and I, took the same position in a letter to Congressmen Brooks and Horton and Senators Cohen and Levin on August 16, 1985. We jointly took the position that we declined to publish a change in the Federal Register, substituting a sufficient number for the Rule of Two, and, fundamentally, I find no basis to substitute something that works, that is clear, that is consistent in our opinion with the statute for something that is vague, will probably cause a measure of confusion, and from which one can draw the inference: if two or more is not adequate, a sufficient number is probably something higher. That is the only inference I can draw from it.

We further feel that competition has traditionally been defined as two or more firms competing for the award of a contract, and in CICA itself, it sets one standard under sealed bidding in section 2711(a)(1), where it states you will seek sealed bids where you have the expectation of receiving more than one.

That is a procurement determination as to how you proceed; so is a set-aside determination. My question would be: Why impose a higher standard on a small business set-aside than you do on unrestricted formal advertising or sealed bidding?

The second question you posed to us was with respect to whether, in our opinion, OFPP acted consistent with its statute. Our opinion is yes, it did. There are two conditions under which they can act in the manner in which they did, and that is one where there is disagreement among DOD, GSA, and NASA, and the second one is where the three regulatory agencies, DOD, GSA, and NASA, do not act in a timely manner.

I would say in this case, that OFPP was clearly on notice that we were not going to act. It was not a matter of a timely manner, it was a matter of not acting at all. And, so, I have no difficulty with the manner in which they acted.

I would emphasize that this is a proposed rule they put out and we will, indeed, comment on that rule consistent with our testimony today and our past actions.

Finally, you asked what impact we foresee this will have on set-asides. It is very difficult to determine. I would go back to what I said before, that we followed DOD's adoption of the Rule of Two in 1982 to have a consistent set of guidelines to our contracting officers that, in our judgment, were quite clear.

To substitute what I consider to be a vague standard imposes a requirement to make a decision or judgment by a whole range of contracting officers which will lead precisely to this thing we intended to avoid.

So, while it is hard to foresee what will happen to our set-asides and 40 percent of our small business direct awards were set-asides, it is bound in some manner to introduce a measure of confusion in it.

Again, I would say I appreciate being here today, Mr. Chairman, and I will be happy to answer any questions the committee may have.

[Admiral Evans' prepared statement, with attachments, follows:]

PREPARED STATEMENT OF ADM. STUART J. EVANS, ASSISTANT ADMINISTRATOR FOR PROCUREMENT, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

Mr. Chairman and Members of the Subcommittee, I am pleased to be here today to discuss the Federal Acquisition Regulation (FAR) small business set-aside requirements, commonly referred to as the Rule of Two. I will first address in sequence the questions contained in your letter dated May 27, 1986, and then I would like to provide some background information and NASA's rationale for supporting this regulation as good procurement policy.

Question 1. Is it the legal opinion of your agency that the Competition in Contracting Act (CICA) requires the repeal of the Rule of Two?

Answer. NASA believes that the Rule of Two is not in conflict with CICA and therefore that CICA does not require repeal of this regulation. The basic thrust of CICA is that Government procurement should provide for "full and open competition." CICA defines this term to mean "that all responsible sources are permitted to submit sealed bids or competitive proposals on the procurement." CICA, as amended by Public Law 98-577, expressly recognizes small business set-asides as a legitimate form of full and open competition as long as all eligible small businessess are permitted to compete. The Rule of Two relates only to the decision to set aside a procurement for exclusive participation by small business. Once a procurement is set aside, the rule in no way limits sources that may compete.

Apart from the basic process of full and open competition, agencies should also be concerned with maximizing competition to ensure they obtain goods and services at the lowest reasonable cost. For this reason, CICA also instructs agencies to increase their use of full and open competition by establishing policies and procedures to assure that the Government receives a sufficient number of sealed bids or competitive proposals to fulfill its requirements at the lowest reasonable cost. In terms of CICA, this means agencies should use advance procurement planning, Commerce Business Daily synopsizing, specifications that are not unnecessarily restrictive, or any other method to remove barriers to competition and to ensure that as many potential sources as possible are permitted to compete. The policies and procedures established by the agencies to increase their use of full and open competition apply equally to the small business set-aside program as to all other procurements.

In summary, we believe that CICA language regarding a "sufficient number" of proposals simply requires the agencies to constantly strive to eliminate restrictions to full and open competition in all procurement actions. We do not believe this or any other provision of CICA requires the contracting officer to make a predetermination that a certain number of small businesses will compete on a particular procurement action. CICA does not, therefore, require repeal of the Rule of Two.

Question 2. Is it the legal opinion of your agency that OFPP properly invoked its authority pursuant to section 6 of the Office of Federal Procurement Policy Act to justify its May 22, 1986, publication?

Answer. Section 6 of the OFPP Act states in part that ". . . the Administrator may prescribe Governmentwide procurement policies which shall be implemented in the single system of Governmentwide procurement regulations . . .". Section 6 also empowers the OFPP to prescribe Governmentwide regulations, procedures and forms when ". . . the Administrator determines that the DOD, the NASA, and the GSA . . . fail to issue Governmentwide regulations, procedures and forms in a timely manner . . .". By letter of March 26, 1986, the Deputy Assistant Secretary of Defense for Procurement informed OFPP that DOD, GSA, and NASA would prefer that OFPP issue their proposed change to the Rule of Two directly. Although we do not believe that the language at issue in CICA was intended by the Congress to repeal the Rule of Two, OFPP appears under all the circumstances to have acted within its authority under section 6 of the OFPP Act in publishing the proposed policy change in the Federal Register for comment.

Question 3. Would adoption of the proposed regulation be likely to adversely affect the share of the prime contract dollar awarded to small business concerns? For each of the last 15 years, what share of the prime contract dollar was awarded to small business and what percent of that amount was awarded through the small business set-aside program?

Answer. The impact of the proposed regulation is difficult to assess at this time. The results of the OFPP May 22, 1986, Federal Register publication may provide some indication of the impact. It is our opinion, however, that the proposed change from the Rule of Two to a sufficient number standard may have an initial adverse impact on the share of prime contract dollars awarded to small business. In this regard, we are concerned that since sufficient number provides no guidance to contracting officers, some contracting officers may not set aside procurement actions for exclusive participation by small business that would otherwise have been set aside under the Rule of Two. The act of changing a long established Rule of Two to an undefined sufficient number could lead to the inference that a sufficient number must mean something else such as a higher number than 2.

Notwithstanding our concern, the Small Business Act requires that a fair proportion of each agencies' procurement dollars be awarded to small business. NASA supports the spirit and intent of the Small Business Act and will continue to negotiate small business contracting goals with the Small Business Administration and will use whatever management tools are available to assure that those goals are met. It should be noted, however, that the Rule of Two is one of those tools and if eliminated will make our job much more difficult.

Attachment A provides the requested procurement statistics for the past 15 years on the share of prime contract dollars awarded to small business and the percentage of that amount that was awarded through the small business set-aside program.

Question 4. Also attach to your statement a copy of any and all correspondence by and between your agency and OMB and OFPP relating to the Rule of Two and the effect of CICA on that regulation.

Answer. We have searched our files and Attachment B contains a copy of all requested correspondence therefrom.

Before I explain NASA's views on the Rule of Two as procurement policy, it should be noted that the Office of Federal Procurement Policy (OFPP) published a notice for comment in the Federal Register on May 22, 1986, requesting the views of the private sector as well as Federal agencies before establishing the administration's position on this issue. We plan to comment in response to that request and will then follow the policy established by the Office of Management and Budget.

The issue of whether the Rule of Two or the "sufficient number" standard is the most appropriate guidance for contracting officers in making a decision to set aside a procurement action for exclusive participation by small business has a long background. To implement the Small Business Act all agencies initially used the "sufficient number" standard which essentially provided no guidance whatsoever to the contracting officer in making a set-aside determination. Based on that standard the question was: How is one to decide what is a sufficient number? Experience proved that without clear and specific guidance, set-aside determinations were being made inconsistently throughout the Government. In 1963 the Navy (followed by all remaining elements of DOD in 1979) changed their regulations to provide the needed specific guidance for making consistent set-aside determinations.

The specific guidance provided by DOD was that a small business set-aside would be made if there is a reasonable expectation that two or more responsible small businesses will compete and that awards will be made at reasonable prices. Competition has traditionally been defined as two or more firms independently contending for award of a contract. CICA continued this traditional definition by stating a section 2711(a)(1) that an executive agency shall solicit sealed bids if there is a reasonable expectation of receiving more than one sealed bid. NASA, having had similar experience regarding inconsistent implementation of the "sufficient number" standard, changed its regulation in 1982 and adopted the Rule of Two. In addition to the need for specific and clear guidance, we felt that since two independently contending firms defines competition for all Federal procurement, we could not justify a stricter standard for small business than is applied to other businesses.

When the initial FAR draft was published for public comment it contained the "sufficient number" standard principally because the Federal Procurement Regulation (FPR), at that time, still contained the "sufficient number" language. When public comment was reviewed and NASA, DOD, and GSA discussed their experiences with both the "sufficient number" and Rule of Two standards, the FAR was changed in the executive review phase to incorporate the Rule of Two.

In 1984, shortly after the effective date of the FAR, CICA was signed into law containing the language at issue. We reviewed the language of CICA and determined that the FAR provisions for making the small business set-aside determination were consistent with the intent and the letter of the law. By letter of August 16, 1985, DOD, GSA, and NASA jointly informed the Committee on Government Operations, House of Representatives, and the Subcommittee on Oversight of Government Management, Committee on Governmental Affairs, U.S. Senate, of this position which we still hold today.

ATTACHMENT A

SMALL BUSINESS PARTICIPATION IN NASA PROCUREMENTS
FISCAL YEARS 1971 - 1985

(Dollars in Millions)

	FY 1971	FY 1972	FY 1973	FY 1974	FY 1975
Total Business	$2,279.5	$2,143.3	$2,063.8	$2,118.6	$2,255.0
Small Business	$178.1	$160.9	$155.3	$181.2	$216.0
% of Total Business	7.8%	7.5%	7.5%	8.6%	9.6%
Set-Asides	$41.1	$45.1	$47.3	$61.5	$62.6
% of Small Business	23.1%	28.0%	30.5%	33.9%	29.0%

	FY 1976	FY 1977	FY 1978	FY 1979	FY 1980
Total Business	$2,536.1	$2,838.1	$2,953.8	$3,416.4	$3,868.3
Small Business	$218.3	$255.0	$281.5	$325.4	$384.6
% of Total Business	8.6%	9.0%	9.5%	9.5%	9.9%
Set-Asides	$66.8	$83.7	$92.5	$99.4	$175.2
% of Small Business	30.6%	32.8%	32.9%	30.5%	45.6%

	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985
Total Business	$4,272.8	$4,805.6	$5,586.0	$5,967.4	$6,652.9
Small Business	$409.4	$430.1	$482.3	$556.2	$644.7
% of Total Business	9.6%	8.9%	8.6%	9.3%	9.7%
Set-Asides	$195.8	$209.3	$212.0	$222.5	$270.0
% of Small Business	47.8%	48.7%	44.0%	40.0%	41.9%

ATTACHMENT B

LISTING OF CORRESPONDENCE BETWEEN NASA AND OMB AND OFPP RELATING TO THE "RULE OF TWO"

a. OMB Memorandum of April 5, 1984

b. NASA Letter to Director of OMB of April 17, 1984

c. OFPP Memorandum of February 21, 1986 (w/enclosures)

d. OFPP Memorandum of March 7, 1986 (w/enclosures)

e. DOD Letter of March 26, 1986

Attachment B(a)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 5 1984

MEMORANDUM TO: MARY ANN GILLEECE, DOD
ALLAN BERES, GSA
STU EVANS, NASA

FROM: DAVID A. STOCKMAN

SUBJECT: Response to Congressman Brooks

The attached letter from Congressman Brooks raises questions regarding the "rule of two" small business set-aside provisions in FAR 19.502-2. Please provide information on which to base a response to Mr. Brooks.

It is our view that, while the receipt of responsive offers from two responsible offerors has long been acceptable as evidence of adequate price competition for purposes of complying with P.L. 87-653, it is quite another matter to adopt a standard which limits the competitive field based on the presumption or possibility of competition but which in fact may not ensure either competition or reasonable prices. This appears to have been caused by confusion over the distinction between "competition" as an end result and "competitive procedures."

We would appreciate your response, including your position on changing FAR 19.502-2, by April 13, 1984.

Attachment B(b)

APR 17 1984

Honorable David A. Stockman
Director
Office of Management and Budget
Washington, DC 20530

Dear Mr. Stockman:

This is in reply to your memorandum of April 5, 1984, referencing Congressman Brooks' letter and requesting information on the "rule of two" set-aside provision in subsection 19.502-2 of the Federal Acquisition Regulation (FAR). According to Mr. Brooks, the cited passage contains policies which require that all Federal procurements be set aside exclusively for small business participation if there are two small business concerns available to meet the Government's requirements.

FAR subsection 19.502-2 represents the best efforts of the Executive Agencies to comply with the intent of Congress which is to ensure that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small-business concerns. To carry out this policy, procurement regulations established procedures for both total and partial small business set-aside programs (FPR 1-1.706; DAR 1-706; NASA PR 1.706).

The current FAR coverage at 19.502-2 gives the Executive Agencies a precise formula for deciding when to use total set asides. Until the procurement regulations were amended to include the "rule of two" as a firm standard, the only measure for deciding to make a total small business set aside was whether there was a reasonable expectation that a sufficient number of responsible small business firms would present offers at reasonable prices. The "sufficient number" standard was open to wide interpretation and proved inadequate for deciding when an entire procurement could be blocked out for exclusive small business bidding.

The Department of Defense amended the Defense Acquisition Regulation to include the "rule of two" in July 1979 and NASA adopted the procedure in October 1982, and the process has worked well for both agencies since that time.

The initial version of the FAR that was circulated for comment did not reflect the "rule of two" because that version was based on the Federal Procurement Regulation (FPR) version that enunciated only the "sufficient number" criterion. However, virtually all the public comments received on 19.502-2 (including those of DOD, GSA, NASA and SBA) requested that the language be amended to include the "rule of two." There were two main concerns reflected in the commentors' remarks. First, the "rule of two" is required to be followed in placing small purchases in accordance with P.L. 95-507, and it was logical to follow that policy for other procurements if the procuring agencies were to accomplish the mandate of the Armed Services Act of 1947, the Federal Property and Administrative Services Act of 1949, and the Small Business Act; i.e., to ensure that small business firms receive a fair share of Federal contracts. Secondly, the old "sufficient number" standard was difficult to interpret, leaving the decision to individual officials and thereby running the risk of not having the standard applied uniformly. The published version of the FAR reflects the negotiated agreement between the three procurement regulatory agencies (DOD, GSA, and NASA) to arrive at a workable standard for total set-asides.

The practice of setting aside procurements for small businesses has long been accepted as Congressional policy and that of past and present Administrations. Thus, the FAR merely continues a long-standing practice of partial and total set asides. The current FAR language only represents new policy for former FPR users. It reflects a policy that has been in effect for almost five years in DOD and approximately one and one-half years at NASA.

This situation highlights one of the difficulties experienced by procurement officials, and especially those involved in developing the FAR. That is the problem of the use of the procurement process to acquire goods and services as well as to achieve socio-economic goals. We agree with Congressman Brooks that the free market place should be allowed to decide the recipients of Government contracts. But that cannot happen now with the myriad of existing laws that give preferential treatment to different segments of our society and, in the process, often conflict with each other. Enclosed is a listing of some 83 such programs or statutes that illustrate the difficulties procurement officials are confronted with daily as they attempt to balance the acquisition of goods and services in a fair and economical manner, while at the same time attempting to meet legislated socio-economic objectives.

We do not view the FAR language as permitting one economic group to take over the Federal market place. Small business set asides are used to attain the small business participation goals set pursuant to Public Law 95-507 (15 U.S.C. 644), not to deprive large business of its share or to unduly limit the competitive field. Also, we do not feel that the FAR language violates current law but rather that it reflects what we think is the will of Congress.

In summary, FAR 19.502-2 was written to conform to the public comments received when the first version of the FAR was circulated and, as previously stated, is in furtherance of the mandate to ensure that small business receive a fair proportion of Government contracts. In view of this background, we see no reason to change the FAR language.

Sincerely,

Original Signed By
S. J. Evans

S. J. Evans
Assistant Administrator
for Procurement

Enclosure

HP/HWilson/cdb/453-2105/4-17-84
DocName: Stockman (Jeffries)
Disc: Enclosure

HP W/Hopkins

Attachment B(c)

FEB 2 1 1986

MEMORANDUM TO: SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID P. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses "...if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices."

However, in July 1984, Section 2733 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) Increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... [to achieve] the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. Therefore, further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter 85-1 that within 30 days of the date of this letter the following proposed regulations must be published for a 30 day comment period. This notice has been concurred in by the Director, OMB.

PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 — SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS •

Subpart 19.5 — Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 — SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

Attachment B(d)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 7 1986

''EMORANDUM FOR: ELEANOR R. SPECTOR
DEPARTMENT OF DEFENSE

STUART J. EVANS
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

PATRICIA A. SZERVO
GENERAL SERVICES ADMINISTRATION

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: OFPP Memorandum of February 21, 1986 on Small Business Set-Aside Determination Provisions of the FAR

For the purpose of keeping you informed regarding our February 21 memorandum, I am attaching two pieces of correspondence. The first is our response to Congressman Jack Brooks, dated March 5, 1986. The second is a letter to Secretary Weinberger, dated March 4, 1986, signed by Congressmen Joseph Addabbo, Parren Mitchell, Berkley Bedell and Nicholas Mavroules.

Attachments

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAR 5 1986

Honorable Frank Horton
Committee on Government Operations
U. S. House of Representatives
Washington, DC 20515

Dear Congressman Horton:

This is in reply to your letter of December 20, 1985, on the Total Set-Aside Provisions (TSAP) or "rule of two" contained in the Federal Acquisition Regulation (FAR) 19.502-2.

The TSAP currently provide that an acquisition shall be set aside for exclusive small business participation if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable prices." (Emphasis added.)

As a result of public concern that FAR adoption of the current provision was done without sufficient opportunity for public comment, the Office of Federal Procurement Policy (OFPP), on October 12, 1984, solicited the views of all interested persons on the "rule of two." More than 200 comments were received, of which approximately 65 percent opposed the provision.

Since then, as you note, the continuing validity of the "rule of two" was brought into question by the Competition in Contracting Act (CICA), which established competition principles based on the standard of "a sufficient number" of bids to result in the "lowest reasonable cost" to the Government.

After reviewing the legislative history of CICA and the comments solicited by the 1984 notice, OFPP has determined that the decision to set-aside an acquisition which exceeds $25,000 for exclusive participation by small business must be based upon the standard of competition established therein. Accordingly, we have notified the three procurement agencies that they must publish for comment a proposed rule revoking the rule of two. Such publication must occur within 30 days to be considered "timely" and avoid OFPP's directly exercising its independent statutory authority to prescribe this procurement regulation.

We trust this satisfactorily responds to your letter.

Sincerely,

Joe Wright

Joseph R. Wright, Jr.
Deputy Director

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MAJORITY—225-5051
MINORITY—225-5074

15 DEC 24

CE UNIT

December 20, 1985

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

As you know, we strongly believe that the Federal procurement process should be made more competitive, so that agencies will receive the best appropriate goods and services at the lowest possible overall cost. The Competition in Contracting Act, enacted last year on our recommendation in Public Law 98-369, makes full and open competition the standard for Federal procurements.

A number of statutes and regulations, however, still interfere with appropriate implementation of this Act, and consequently deprive our citizens of the opportunity to get the best buys for their tax dollars. Prominent among these regulations is the "rule of two," which permits agency officials to set a contract aside for award only to a small business whenever the officials think that two or more small firms might want to perform the work. Once a contract is set aside, any efficient company which is larger than the size established under Small Business Administration regulations may not be awarded that contract--even if it can do the work better, and at a lower price, than a small firm can.

This "rule of two" was inserted into the Federal Acquisition Regulation without public comment prior to enactment of the Competition Act. It is clearly inconsistent with the spirit of that law. Furthermore, it has no basis in statute. In fact, in the same year that Congress approved the Act, the House of Representatives, at the urging of numerous committee chairmen and ranking minority members, chose not to consider a bill whose principal provision would have given statutory authority to the rule.

When the Competition Act became effective last April, the FAR should have been amended to bring the "rule of two" into conformity with the Act. Despite the inconsistency between the Act and the rule, and despite the numerous public comments which the Office of Federal Procurement Policy received in opposition to the rule at the end of 1984, the FAR still has not been amended.

We urge you and the OFPP to replace the rule with regulations which comply with the Competition Act and therefore further an objective which you and we share: achieving better buys through increased competition in Federal procurement.

Sincerely,

Jack Brooks
JACK BROOKS
Chairman

Frank
FRANK HORTON
Ranking Minority Member

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Congress of the United States
House of Representatives
COMMITTEE ON SMALL BUSINESS
2361 Rayburn House Office Building
Washington, DC 20515

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JOHN HILER, INDIANA
VIN WEBER, MINNESOTA
DAVID DREIER, CALIFORNIA
D. FRENCH SLAUGHTER, JR., VIRGINIA
JIM KOLBE, ARIZONA
WILLIAM W. COBEY, JR., NORTH CAROLINA
ROBERT C. SMITH, NEW HAMPSHIRE
HOWARD COBLE, NORTH CAROLINA
JOSEPH J. DioGUARDI, NEW YORK
JAN MEYERS, KANSAS
DEAN A. GALLO, NEW JERSEY
J. ALEX McMILLAN, NORTH CAROLINA
STEWART B. McKINNEY, CONNECTICUT
LARRY COMBEST, TEXAS

MAJOR L. CLARK III, STAFF DIRECTOR
THOMAS G. POWERS, GENERAL COUNSEL
CHRISTINE A. RUSSELL, MINORITY STAFF
DIRECTOR

MAJORITY—225-5821
MINORITY—225-4038

AREA CODE 202

March 4, 1986

Honorable Caspar W. Weinberger
Secretary
Department of Defense
The Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

This Committee has received a copy of a February 21, 1986 memorandum authored by David F. Baker, Acting Administrator of the Office of Federal Procurement Policy (OFPP), and addressed to the Secretary of Defense and the Administrators of the National Aeronautics and Space Administration (NASA) and the General Services Administration (GSA). This memorandum purports to exercise OFPP's authority pursuant to 41 U.S.C. section 405, as implemented by OFPP Letter 85-1. The subject of the memorandum is the "Small Business Set-Aside Determination Provisions of FAR."

We have reviewed the memorandum and, for the reasons stated below, do not believe it was issued "with due regard for applicable laws and the program activities of the executive agencies" (41 U.S.C. section 405(a)). Accordingly, we recommend that DoD, NASA, and GSA delay any requested publication until the issue of OFPP compliance with the statute is resolved by the President.

OFPP claims that the subject memorandum is required by section 2733 of the Competition in Contracting Act of 1984 (CICA). That provision amended section 16(1) of the OFPP Act to read as follows:

> "To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

Reading this statutory provision OFPP has concluded that:

(1) the so-called "rule of two" found in section 19.502 of the FAR should be repealed;

(2) a set-aside cannot take place unless the contracting officer demonstrates that a sufficient number of responsible small business concerns "will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost ...";

(3) a class set-aside cannot take place unless the contracting officer makes a written determination that the demonstration referred to in (2) "can be achieved on each procurement in that class, evaluating in detail ... quality, timeliness and cost factors"; and

(4) a repetitive set-aside cannot take place unless the contracting officer makes a written determination reaffirming that small business will submit the lowest reasonable cost.

OFPP's extreme interpretation is in contradiction with the clear meaning of relevant provisions of the CICA.

As you know, CICA amended, among other things, both the Federal Property and Administrative Services Act (FPASA) and, what is commonly referred to as the Armed Services Procurement Act (ASPA). For the sake of this discussion, we shall refer only to sections of the FPASA since CICA amends both statutes with identical provisions in the area here relevant.

Section 303(a) of FPASA generally requires that agencies obtain full and open competition through the use of competitive procedures. Subsection (b) of this same section, as amended by P.L. 98-577 (October 30, 1984), authorizes agencies to use competitive procedures but to exclude a specific source or, in the case of small business set-asides, to exclude all sources other than small business concerns.

Section 309(b) of FPASA, as amended by P.L. 98-577, defines competitive procedures as including small business set-asides "as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete."

Reading sections 303 and 309 together, it is clear that small business set-asides are to be deemed as full and open competition using competitive procedures provided that the buying agency does not limit the number of eligible small businesses that may submit an offer in response to a set-aside solicitation.

The provision cited by OFPP as requiring its proposed rule change (section 2733 of CICA, 42 U.S.C. section 414(1)), is a direction to Federal agency heads that, when implementing the FAR, they not adopt internal policies, procedures and practices that would unnecessarily restrict the number of otherwise eligible sources that could compete for the award. It is our impression that such unnecessary inhibitors to full and open competition may, in particular circumstances, include bonding requirements, restrictive specifications, geographic limitations, directed subcontracting sources, and other definitive elements of responsibility not justifiable in

light of the particular agency need in question. Such restrictions would, of course, militate against the use of full and open competition and its concomitant benefit of lowering costs. Our interpretation is fully consistent with sections 303 and 309 of the FPASA which preclude an agency from limiting the number of eligible small businesses that may compete for a set-aside. Indeed, if such a limitation would occur, that procurement would no longer be deemed full and open competition.

The "rule of two" has nothing whatsoever to do with a limitation on the number of eligible competing sources. The rule is applied prospectively (before the requirement is synopsized) by a contracting officer to determine whether a procurement should be set-aside -- not whether an eligible small business should be precluded from submitting an offer.

Aside from the fact that the proposed regulation is not required by CICA, the regulation, if adopted, would also have a detrimental effect on the Federal acquisition process. By way of illustration, consider the following:

(1) How can a contracting officer equitably administer a "lowest reasonable cost" standard when the particular acquisition in question may be awarded under source selection criteria that subordinate cost to technical merit?

(2) Can the "lowest reasonable cost" standard ever be met if a large business indicates an interest in submitting an offer?

(3) In those relatively few instances when the contracting officer can demonstrate that only small business will submit proposals and, therefore, that the "lowest reasonable cost" test will be satisfied, are not set-asides rendered meaningless since the awards will be made to small business regardless of the procurement strategy used? Is it reasonable for OFPP to assume that Congress intended to render the set-aside authority a practical nullity through the strained construction of a statutory provision that does not even mention set-asides?

(4) Why does CICA require "a reasonable expectation of receiving more than one sealed bid" as the standard for a sealed bid procurement (section 2711(a)(1)), but, as interpreted by OFPP, require a more stringent standard for small business set-asides?

(5) How can an agency expect its program activities to expand competition and the mobilization base (see section 15(a) of the Small Business Act) if it cannot limit the concentration of contracts through the use of set-asides?

(6) Would adoption of the regulation set a precedent that the Administrator of OFPP has the authority to implement -- through memoranda -- the responsibilities reserved to agency heads under 41 U.S.C. section 414?

We fully understand that certain buying agencies have experienced difficulties with set-asides in some industrial areas because of faulty size standards adopted by the Small Business Administration (SBA). However, we believe the solution to that problem is size standard reform, not the effective elimination of set-asides.

For the reasons cited above, we again urge that publication of the proposal be indefinitely delayed so that DoD, NASA, and GSA have an opportunity to present their positions on these most important issues directly to the President.

If you should have any questions regarding this letter, please have a member of your staff contact our Committee's Legislative Counsel, Tom Trimboli, at 225-4351.

Sincerely,

Joseph P. Addabbo
Joseph P. Addabbo, M.C.

Parren J Mitchell
Parren J. Mitchell
Chairman

Berkley Bedell
Berkley Bedell, M.C.

Nicholas Mavroules
Chairman, Subcommittee on General Oversight and the Economy

PJM:ttf

cc: Norma Leftwich, Director
Office of Small & Disadvantaged Business Utilization, Department of Defense

John Wynn, Director
Office of Small & Disadvantaged Business Utilization, General Services Administration

Eugene Rosen, Director
Office of Small & Disadvantaged Business Utilization, National Aeronautics and Space Administration

Attachment B(e)

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND
LOGISTICS

26 MAR 1986

Mr. David F. Baker
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Room 9001
New Executive Office Building
Washington, DC 20503

Dear Mr. Baker:

In response to your request, this confirms my telephone call to you on March 21, 1986, regarding publishing your proposed change to the "rule of two" in the Federal Register. As I stated, we are concerned about Office of Federal Procurement Policy (OPFF) not following the agreement that we had worked out as set forth in OFPP policy letter 85-1 dated August 19, 1985.

However, this is not the underlying reason for my statement to you that we prefer OFPP publish the proposed change to the "rule of two." It is clear that the proposed change will be controversial. Were we to publish the change, we anticipate receiving a number of objections and requests for justification for the change from small business supporters in the Congress. After discussing this with my colleagues in GSA and NASA, we concluded that, since you have been the proponent of the change, it would be preferable for you to publish the policy directly. Of course we would assist you in this where we could.

Sincerely,

Eleanor Spector

Eleanor R. Spector
Deputy Assistant Secretary of
Defense for Procurement

Mr. MITCHELL. Thank you, Admiral Evans. Ms. Szervo.

TESTIMONY OF PATRICIA A. SZERVO, ASSOCIATE ADMINISTRATOR FOR ACQUISITION POLICY, GENERAL SERVICES ADMINISTRATION

Ms. SZERVO. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you today to discuss the Office of Federal Procurement Policy's proposal with respect to the so-called Rule of Two or More. I will be very brief now and respond directly to the questions that you have asked of GSA.

The first one is: Does the Competition and Contracting Act require the repeal of the Rule of Two? It is the opinion of GSA that the Rule of Two is not in conflict with the provision of CICA.

I will not repeat what Admiral Evans has so succinctly summarized as the position of the three regulatory agencies on the Rule of Two and the reasons for it.

The second question that you asked of us was: Did the Office of Federal Procurement Policy properly invoke its authority to justify its May 22, 1986, publication?

It is the opinion of GSA that section 6 of the Office of Federal Procurement Policy Act clearly grants OFPP the authority to prescribe Governmentwide procurement policy, although GSA believes that the statement of procurement policy would have been a more appropriate vehicle than the direct amendment of the FAR. It is our opinion that OFPP can properly invoke its authorities under section 6 of the OFPP Act to establish this policy contained in its May 22 publication.

The third question that you asked us was: Would adoption of the proposed regulation be likely to adversely affect the share of prime contract dollars awarded to small business concerns?

A comparison of the GSA procurement data for the 5-year period, from fiscal year 1981 through fiscal year 1985, a copy of which is attached to my prepared statement, indicates that the April 1984 conversion to the "Rule of Two or More" under the FAR had no apparent effect on the share of prime contract dollars awarded to small businesses under GSA's set-aside program.

Although such forecasts are highly conjectural, it is possible that a return to the sufficiency standard would likewise have little impact on our set-aside program. We do note, however, that in requiring the contracting officer to demonstrate, that is the language of the provision, that a sufficient number of small business concerns will respond to fulfill the Government's requirements at the lowest reasonable cost, the proposed OFPP language would place a greater administrative burden on the contracting officer in establishing a total small business set-aside than was required under the FPR.

Consequently, we cannot at the present time accurately predict the impact of the proposed OFPP regulation on the share of prime contracts awarded to small businesses.

Thank you, sir.

[Ms. Szervo's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF PATRICIA A. SZERVO, ASSOCIATE ADMINISTRATOR FOR ACQUISITION POLICY, GENERAL SERVICES ADMINISTRATION

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you today to discuss the Office of Federal Procurement Policy's proposal to repeal the so-called Rule of Two, as is currently set forth in the Federal Acquisition Regulation (FAR). The rule, which is prescribed by FAR 19.502-2, provides that when a contracting officer concludes that it is appropriate to set aside an acquisition for small business concerns, the acquisition must be totally set aside if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices."

In your letter inviting the participation of the General Services Administration (GSA) in this hearing, you requested that our testimony address a number of questions. I will briefly discuss the GSA position on each of the questions.

Question. Does the Competition in Contracting Act (CICA) require the repeal of the Rule of Two?

Answer. It is the legal opinion of GSA that the Rule of Two is not in conflict with the provisions of CICA. CICA requires agencies to use competitive procedures in the acquisition of property and services, except in those circumstances where the use of other than competitive procedures is authorized by law. Competitive procedures are those where all responsible sources are permitted to submit offers on a procurement. CICA specifically includes small business set-aside procedures as competitive procedures, provided that all eligible concerns are given the opportunity to compete. The Rule of Two is not a restriction on the number of concerns which may compete in a small business set-aside procurement. Rather, the rule serves only as a method by which an agency determines whether to establish a total set-aside. The determination is based upon the likelihood that a competitive solicitation for offers will result in the receipt of at least two offers from eligible concerns and that award will be made at the lowest reasonable cost. Thus, the Rule of Two is simply a forecast as to the result of the use of competitive procedures and, accordingly, is not inconsistent with the procedural requirements of the act.

Question. Did the Office of Federal Procurement Policy (OFPP) properly invoke its authority to justify its May 22, 1986 publication?

Answer. On May 22, 1986, OFPP published in the Federal Register a proposed change to the FAR regarding small business set-aside determinations. It is the legal opinion of GSA that section 6 of the Office of Federal Procurement Policy Act clearly grants OFPP the authority to prescribe Governmentwide procurement policies. Although we believe that a statement of procurement policy would be a more appropriate vehicle than the direct amendment of the FAR, it is our opinion that OFPP can properly invoke its authorities under section 6 of the OFPP Act to establish the policy contained in the May 22 publication.

Question. Would adoption of the proposed regulation be likely to adversely affect the share of the prime contract dollar awarded to small business concerns?

Answer. Prior to April 15, 1984, GSA was governed by the Federal Procurement Regulations (FPR), which did not contain the Rule of Two. Instead, the FPR provided as the criteria for making a total small business set-aside that "there must be a reasonable expectation that bids or proposals will be obtained from a sufficient number of responsible concerns, organizations, and individuals so that awards would be made at reasonable prices." A comparison of GSA procurement data for the 5-year period from fiscal year 1980 through fiscal year 1985, a copy of which is attached for the record, indicates that the April 1984 conversion to the Rule of Two under the FAR had no apparent effect on the share of prime contract dollars awarded to small businesses under GSA's set-aside program. Although such forecasts are highly conjectural, it is possible that a return to the "sufficiency" standard would likewise have little impact on our set-aside program. We do note, however, that in requiring the contracting officer to demonstrate that "a sufficient number of small business concerns will respond to fulfill the Government's requirements . . . at the lowest reasonable cost . . . ," the proposed OFPP language would place a greater administrative burden on the contracting officer in establishing a total small business set-aside than was required under the FPR. Consequently, we cannot at the present time accurately predict the impact of the proposed OFPP regulation on the share of prime contracts awarded to small businesses. In any event, regardless of the standard used, GSA will continue its efforts to ensure that a fair portion of its contracts are placed with small business concerns.

As you requested, we have also attached to the statement copies of the correspondence between GSA and OMB/OFPP relating to the Rule of Two.

[Dollars in thousands]

	Total procurement [1]	Total amount of contracts awarded to small business [1]	Percent of total procurement	Total amount of contracts awarded under small business set asides [1]	Percent of total small business awards
Fiscal year:					
1981	$3,521,323	$1,415,814	40.2	$481,062	34.0
1982	3,937,310	1,828,491	46.4	505,986	27.7
1983	4,113,195	1,408,249	34.2	509,542	36.2
1984	4,611,445	1,868,409	40.5	598,438	32.0
1985	5,984,637	1,922,789	32.1	660,385	34.3
October–March fiscal year 1986	3,061,611	910,011	29.7	257,303	28.3

[1] Contracts of $10,000 or more.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 7 1986

MEMORANDUM FOR: ELEANOR R. SPECTOR
DEPARTMENT OF DEFENSE

STUART J. EVANS
NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

PATRICIA A. SZERVO
GENERAL SERVICES ADMINISTRATION

David Baker

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: OFPP Memorandum of February 21, 1986 on Small Business Set-Aside Determination Provisions of the FAR

For the purpose of keeping you informed regarding our February 21 memorandum, I am attaching two pieces of correspondence. The first is our response to Congressman Jack Brooks, dated March 5, 1986. The second is a letter to Secretary Weinberger, dated March 4, 1986, signed by Congressmen Joseph Addabbo, Parren Mitchell, Berkley Bedell and Nicholas Mavroules.

Attachments

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. [illegible]

MAR 5 1986

Honorable Frank Horton
Committee on Government Operations
U. S. House of Representatives
Washington, DC 20515

Dear Congressman Horton:

This is in reply to your letter of December 20, 1985, on the Total Set-Aside Provisions (TSAP) or "rule of two" contained in the Federal Acquisition Regulation (FAR) 19.502-2.

The TSAP currently provide that an acquisition shall be set aside for exclusive small business participation if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable prices." (Emphasis added.)

As a result of public concern that FAR adoption of the current provision was done without sufficient opportunity for public comment, the Office of Federal Procurement Policy (OFPP), on October 12, 1984, solicited the views of all interested persons on the "rule of two." More than 200 comments were received, of which approximately 65 percent opposed the provision.

Since then, as you note, the continuing validity of the "rule of two" was brought into question by the Competition in Contracting Act (CICA), which established competition principles based on the standard of "a sufficient number" of bids to result in the "lowest reasonable cost" to the Government.

After reviewing the legislative history of CICA and the comments solicited by the 1984 notice, OFPP has determined that the decision to set-aside an acquisition which exceeds $25,000 for exclusive participation by small business must be based upon the standard of competition established therein. Accordingly, we have notified the three procurement agencies that they must publish for comment a proposed rule revoking the rule of two. Such publication must occur within 30 days to be considered "timely" and avoid OFPP's directly exercising its independent statutory authority to prescribe this procurement regulation.

We trust this satisfactorily responds to your letter.

Sincerely,

Joe Wright

Joseph R. Wright, Jr.
Deputy Director

NINETY-NINTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, DC 20515

15 DEC 24

December 20, 1985

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

As you know, we strongly believe that the Federal procurement process should be made more competitive, so that agencies will receive the best appropriate goods and services at the lowest possible overall cost. The Competition in Contracting Act, enacted last year on our recommendation in Public Law 98-369, makes full and open competition the standard for Federal procurements.

A number of statutes and regulations, however, still interfere with appropriate implementation of this Act, and consequently deprive our citizens of the opportunity to get the best buys for their tax dollars. Prominent among these regulations is the "rule of two," which permits agency officials to set a contract aside for award only o a small business whenever the officials think that two or more small firms might want to perform the work. Once a contract is set aside, any efficient company which is larger than the size established under Small Business Administration regulations may not be awarded that contract--even if it can do the work better, and at a lower price, than a small firm can.

This "rule of two" was inserted into the Federal Acquisition Regulation without public comment prior to enactment of the Competition Act. It is clearly inconsistent with the spirit of that law. Furthermore, it has no basis in statute. In fact, in the same year that Congress approved the Act, the House of Representatives, at the urging of numerous committee chairmen and ranking minority members, chose not to consider a bill whose principal provision would have given statutory authority to the rule.

When the Competition Act became effective last April, the FAR should have been mended to bring the "rule of two" into conformity with the Act. Despite the inconistency between the Act and the rule, and despite the numerous public comments which he Office of Federal Procurement Policy received in opposition to the rule at the end f 1984, the FAR still has not been amended.

We urge you and the OFPP to replace the rule with regulations which comply with he Competition Act and therefore further an objective which you and we share: achieving better buys through increased competition in Federal procurement.

Sincerely,

Jack Brooks
JACK BROOKS
Chairman

Frank
FRANK HORTON
Ranking Minority Member

22058

PARREN J. MITCHELL, MARYLAND,
Chairman
[illegible]

Congress of the United States
House of Representatives
COMMITTEE ON SMALL BUSINESS
2361 Rayburn House Office Building
Washington, DC 20515

[illegible]

March 4, 1986

Honorable Caspar W. Weinberger
Secretary
Department of Defense
The Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

This Committee has received a copy of a February 21, 1986 memorandum authored by David F. Baker, Acting Administrator of the Office of Federal Procurement Policy (OFPP), and addressed to the Secretary of Defense and the Administrators of the National Aeronautics and Space Administration (NASA) and the General Services Administration (GSA). This memorandum purports to exercise OFPP's authority pursuant to 41 U.S.C. section 405, as implemented by OFPP Letter 85-1. The subject of the memorandum is the "Small Business Set-Aside Determination Provisions of FAR."

We have reviewed the memorandum and, for the reasons stated below, do not believe it was issued "with due regard for applicable laws and the program activities of the executive agencies" (41 U.S.C. section 405(a)). Accordingly, we recommend that DoD, NASA, and GSA delay any requested publication until the issue of OFPP compliance with the statute is resolved by the President.

OFPP claims that the subject memorandum is required by section 2733 of the Competition in Contracting Act of 1984 (CICA). That provision amended section 16(1) of the OFPP Act to read as follows:

> "To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

Reading this statutory provision OFPP has concluded that:

(1) the so-called "rule of two" found in section 19.502 of the FAR should be repealed;

(2) a set-aside cannot take place unless the contracting officer demonstrates that a sufficient number of responsible small business concerns "will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost ...";

(3) a class set-aside cannot take place unless the contracting officer makes a written determination that the demonstration referred to in (2) "can be achieved on each procurement in that class, evaluating in detail ... quality, timeliness and cost factors"; and

(4) a repetitive set-aside cannot take place unless the contracting officer makes a written determination reaffirming that small business will submit the lowest reasonable cost.

OFPP's extreme interpretation is in contradiction with the clear meaning of relevant provisions of the CICA.

As you know, CICA amended, among other things, both the Federal Property and Administrative Services Act (FPASA) and, what is commonly referred to as the Armed Services Procurement Act (ASPA). For the sake of this discussion, we shall refer only to sections of the FPASA since CICA amends both statutes with identical provisions in the area here relevant.

Section 303(a) of FPASA generally requires that agencies obtain full and open competition through the use of competitive procedures. Subsection (b) of this same section, as amended by P.L. 98-577 (October 30, 1984), authorizes agencies to use competitive procedures but to exclude a specific source or, in the case of small business set-asides, to exclude all sources other than small business concerns.

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Reading sections 303 and 309 together, it is clear that small business set-asides are to be deemed as full and open competition using competitive procedures provided that the buying agency does not limit the number of eligible small businesses that may submit an offer in response to a set-aside solicitation.

The provision cited by OFPP as requiring its proposed rule change (section 2733 of CICA, 42 U.S.C. section 414(1)), is a direction to Federal agency heads that, when implementing the FAR, they not adopt internal policies, procedures and practices that would unnecessarily restrict the number of otherwise eligible sources that could compete for the award. It is our impression that such unnecessary inhibitors to full and open competition may, in particular circumstances, include bonding requirements, restrictive specifications, geographic limitations, directed subcontracting sources, and other definitive elements of responsibility not justifiable in

light of the particular agency need in question. Such restrictions would, of course, militate against the use of full and open competition and its concomitant benefit of lowering costs. Our interpretation is fully consistent with sections 303 and 309 of the FPASA which preclude an agency from limiting the number of eligible small businesses that may compete for a set-aside. Indeed, if such a limitation would occur, that procurement would no longer be deemed full and open competition.

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Aside from the fact that the proposed regulation is not required by CICA, the regulation, if adopted, would also have a detrimental effect on the Federal acquisition process. By way of illustration, consider the following:

(1) How can a contracting officer equitably administer a "lowest reasonable cost" standard when the particular acquisition in question may be awarded under source selection criteria that subordinate cost to technical merit?

(2) Can the "lowest reasonable cost" standard ever be met if a large business indicates an interest in submitting an offer?

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(4) Why does CICA require "a reasonable expectation of receiving more than one sealed bid" as the standard for a sealed bid procurement (section 2711(a)(1)), but, as interpreted by OFPP, require a more stringent standard for small business set-asides?

(5) How can an agency expect its program activities to expand competition and the mobilization base (see section 15(a) of the Small Business Act) if it cannot limit the concentration of contracts through the use of set-asides?

(6) Would adoption of the regulation set a precedent that the Administrator of OFPP has the authority to implement -- through memoranda -- the responsibilities reserved to agency heads under 41 U.S.C. section 414?

We fully understand that certain buying agencies have experienced difficulties with set-asides in some industrial areas because of faulty size standards adopted by the Small Business Administration (SBA). However, we believe the solution to that problem is size standard reform, not the effective elimination of set-asides.

For the reasons cited above, we again urge that publication of the proposal be indefinitely delayed so that DoD, NASA, and GSA have an opportunity to present their positions on these most important issues directly to the President.

If you should have any questions regarding this letter, please have a member of your staff contact our Committee's Legislative Counsel, Tom Trimboli, at 225-4351.

Sincerely,

Joseph P Addabbo
Joseph P. Addabbo, M.C.

Parren J Mitchell
Parren J. Mitchell
Chairman

Berkley Bedell
Berkley Bedell, M.C.

Nicholas Mavroules
Chairman, Subcommittee on General Oversight and the Economy

PJM:ttf

cc: Norma Leftwich, Director
Office of Small & Disadvantaged Business Utilization, Department of Defense

John Wynn, Director
Office of Small & Disadvantaged Business Utilization, General Services Administration

Eugene Rosen, Director
Office of Small & Disadvantaged Business Utilization, National Aeronautics and Space Administration

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

FEB 21 1986

MEMORANDUM TO: SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
✓ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses "...if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices."

However, in July 1984, Section 2733 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1934. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... [to achieve] the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. Therefore, further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter 85-1 that within 30 days of the date of this letter the following proposed regulations must be published for a 30 day comment period. This notice has been concurred in by the Director, OMB.

PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 — SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 — Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 — SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

APR 16 1984

Honorable David A. Stockman
Director
Office of Management and Budget
Washington, DC 20503

Dear Mr. Stockman:

This is in reply to your memorandum of April 5, 1984, referencing Congressman Brooks' letter and requesting information on the small business set-aside provisions in FAR 19.502-2.

Congressman Brooks stated that the FAR contains provisions which require "that all Federal procurements be set aside exclusively for small business participation if there are two small business concerns available to meet the Government requirements."

This is an incorrect interpretation in that the FAR does not require procurements be set aside unless the criteria of Part 19.502-1 are met. Part 19.502-1 provides:

> 19.502-1 Requirements for setting aside acquisitions. Using the order of precedence in 19.504, the contracting officer shall set aside an individual acquisition or class of acquisitions when it is determined to be in the interest of (a) maintaining or mobilizing the Nation's full productive capacity, (b) war or national defense programs, or (c) assuring that a fair proportion of Government contracts is placed with small business concerns, and when the circumstances described in 19.502-2 or 19.502-3(a) are met.

If a decision to set aside is made under 19.502-1, the formulas for deciding whether the set aside should be total or partial are contained in 19.502-2 and 19.502-3, respectively.

In regard to Congressman Brooks' concerns over the "rule of two," it should be understood that it applies only after a decision to set aside has been made in accordance with 19.502-1. In other words, it does not determine if there will be a set aside, but does determine the extent of a set aside. The current FAR language in 19.502-2 represents new policy only for former Federal Procurement Regulations (FPR) users. It is a policy that has been in effect for almost 5 years in DOD and approximately 1 1/2 years at NASA.

Until the procurement regulations were amended to include this "rule of two" as a firm standard, the sole measure for deciding to make a small business set-aside total was whether there was "a reasonable expectation" that a "sufficient number" of responsible small business firms would present offers "at reasonable prices." The "sufficient number" standard was open to wide interpretation and proved inadequate for deciding when an entire procurement could be blocked out for exclusive small business bidding.

The initial version of the FAR that was circulated for comment did not reflect the "rule of two" because that version was based on the FPR version that enunciated only the "sufficient number criterion." However, virtually all of the public comments received on 19.502-2 (including those of DOD, GSA, NASA and SBA) requested that the language be amended to include the "rule of two." There were two main concerns reflected in the commentors remarks. First, the "rule of two" was required to be followed in placing small purchases in accordance with Pub. L. 95-507, and it was logical to follow that policy for other acquisitions if the contracting agencies were to accomplish the mandate of the Armed Services Procurement Act of 1947, the Federal Property and Administrative Services Act of 1949, and the Small Business Act; i.e, to ensure that small businesses received a fair share of Federal contracts. Secondly, the old "sufficient number" standard was difficult to interpret, leaving the decision to individual officials and thereby running the risk of not having the standard applied uniformly. The published version of the FAR reflects the negotiated agreement between the three procurement regulatory agencies — DOD, GSA and NASA — to arrive at a workable standard for total set-asides.

In summary, the confusion over the "rule of two" has developed as a result of reading FAR 19.502-2 out of context. FAR 19.502 must be read in total in order to apply the policies for total or partial set asides. At this time we do not consider it necessary to modify the FAR since the basic policy for setting aside acquisitions has not been changed.

Sincerely,

signed
William [illegible]

ALLAN W. BERES
Assistant Administrator
for Acquisition Policy

APR 5 1984

MEMORANDUM TO: MARY ANN GILLEECE, DOD
ALLAN BERES, GSA
STU EVANS, NASA

FROM: DAVID A. STOCKMAN D. A. S.

SUBJECT: Response to Congressman Brooks

The attached letter from Congressman Brooks raises questions regarding the "rule of two" small business set-aside provisions in FAR 19.502-2. Please provide information on which to base a response to Mr. Brooks.

It is our view that, while the receipt of responsive offers from two responsible offerors has long been acceptable as evidence of adequate price competition for purposes of complying with P.L. 87-653, it is quite another matter to adopt a standard which limits the competitive field based on the presumption or possibility of competition but which in fact may not ensure either competition or reasonable prices. This appears to have been caused by confusion over the distinction between "competition" as an end result and "competitive procedures."

We would appreciate your response, including your position on changing FAR 19.502-2, by April 13, 1984.

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NINETY-EIGHTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, D.C. 20515

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MAR16 9
CE UNIT

March 14, 1984

The Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Dave:

It has come to my attention that the Federal Acquisition Regulation (FAR), which is to become effective on April 1, 1984, contains provisions which require that all Federal procurements be set aside exclusively for small business participation if there are two small business concerns available to meet the government's requirements. These provisions violate current law and create a serious restriction on the government's ability to obtain goods and services from the maximum practicable number of vendors at the lowest cost.

While I support efforts to open up the Federal marketplace to small business, I strongly oppose these provisions. It is inherently unfair to turn over the Federal marketplace to any single economic group. The major purpose of procurement is to serve agency missions in a cost-effective manner. If we sacrifice this principle in order to achieve other goals, it will not only substantially increase costs, but may do untold harm to agency missions.

It is my understanding that the "rule of two" set aside provisions were not included in the version of the FAR that went out for public comment. I would appreciate an explanation of how they came to be included in the regulation and at whose request. In any case, I recommend that you take action to remove these provisions before they become effective on April 1.

With best wishes, I am

Sincerely,

Brooks

JACK BROOKS
Chairman

FAR 19.502-2

17909

Mr. MITCHELL. Thank you, and thank all three of you.

Prior to the May 22 publication, how many times did each of you inform either OMB or the Office of Federal Procurement Policy, in your opinion, that CICA did not require the repeal of the Rule of Two?

Can you recall how many times you advised them of this, of your position? Any one of the witnesses? All three of you?

Ms. SPECTOR. I do not know how many times, but it was several times. I would have to count the number of letters. There was one in response to a package that GAO had put together that Congressman Brooks, I believe, sent us.

There were several occasions where we advised them.

Mr. MITCHELL. More than 2 and less than 10?

Ms. SPECTOR. Yes.

Admiral EVANS. A sufficient number.

Mr. MITCHELL. Touché.

Admiral EVANS. I can respond to that, too, if you would like.

Mr. MITCHELL. Yes, please, Admiral.

Admiral EVANS. I cannot recall precisely, but I know of two occasions wherein I did. A meeting with the then OMB counsel on this subject. I was unaware of it before I got to his office, but that turned out to be the subject.

And in one conversation in February with respect to direction from OFPP to publish that policy. I obviously also concurred with my colleagues here in the position of DOD stating that we would decline to publish.

Mr. MITCHELL. Do you wish to respond?

Ms. LEFTWICH. Yes; by my count, we have four official pieces of correspondence, dating back to 1984, being sent to OMB and OFPP stating our position, sir, and numerous telephone calls.

Mr. MITCHELL. OK. Mr. Evans, on page 7 of your testimony, I think it appears that all three of the regulatory agencies jointly signed a letter, dated August 16, 1985, to the House Government Operations Committee and the Senate Governmental Affairs Committee, stating that the Rule of Two does not violate CICA.

Can you submit a copy of that letter for the record for this hearing?

Admiral EVANS. I would be pleased to.

Mr. MITCHELL. Thank you. We will have that correspondence entered into the record officially as of this time.

[Correspondence requested above, follows:]

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND LOGISTICS

84-204

~~[illegible] AUG 1985~~

DASD(P)/DARS

AUG 16 1985

Honorable Jack Brooks, Chairman
House Committee on
Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This responds to your letter dated July 19, 1985, regarding the implementation of the Competition in Contracting Act (CICA) of 1984 in the Federal Acquisition Regulation (FAR). It also is a further response to your letter of December 12, 1984, which was also signed by Senators Cohen and Levin and Congressman Horton. In both references you expressed concern that certain FAR provisions may be inconsistent with statutory requirements.

As you know, the FAR implementation of CICA was developed by the DAR Council and CAA Council for issuance under very tight time-frames. As a result, the FAR change was issued as a temporary regulation so that interested parties would have adequate opportunity to review and comment on its substance. Comments were due for receipt by March 12, 1985, and it was anticipated that the Councils would turn full attention to their timely resolution and, where appropriate, accommodation in final FAR coverage.

However, enactment of additional procurement legislation in the form of P.L. 98-577 and P.L. 98-525 created additional statutory deadlines for developing major revisions to the FAR. As a result, the Councils have been delayed in their joint efforts to review the over 250 CICA comments received. With implementation of the most recent legislation now substantially behind us, the Councils are focusing their attention on those comments and expect to complete their analysis of all issues by the end of the month. This would permit publication of a final rule in the Federal Register in October.

Enclosed at Attachments #1 and #2, you will find our detailed response to each of the questions posed in the above referenced letters. While the Defense Acquisition Regulatory Council and Civilian Agency Acquisition Council fully agree with each response in the attachments, they still, in the weeks ahead, must develop and reach agreement on the actual revised FAR coverage resulting from your comments, 200 other public comments, and numerous comments from within our agencies.

Please be assured that we share your concern that CICA be implemented in a manner consistent with the law. We believe that our initial implementation plus the revisions referenced above will achieve that goal and establish a regulatory framework that will both foster competition and promote economic and efficient procurement.

Representatives of both Councils are available to meet with members of your staff should you desire further discussions. An identical letter is being sent to Congressman Horton. A similar letter is being sent to Senators Cohen and Levin.

Sincerely,

Eleanor Spector
DEPARTMENT OF DEFENSE
ELEANOR R. SPECTOR
Deputy Assistant Secretary
of Defense for Procurement

GENERAL SERVICES
ADMINISTRATION
ALLAN W. BERES
Assistant Administrator
for Acquisition Policy

NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION
S. J. EVANS
Assistant Administrator
for Procurement

Attachments
# 1-Responses to 12 Dec 84 letter
# 2-Responses to 19 Jul 85 letter

cc: GAO

Responses to 12 December 1984 Letter

1. ((FAR 6.302-1(b)). FAR 6.302-1(b) cites examples in which the first exception to the requirement for full and open competition may be used. Under the first example (FAR 6.302-1(b)(1)), however, the condition for going sole-source -- "the required supplies or services are available from only one source" -- is clearly less restrictive than the statutory exception, which requires as a further condition that no other type of property or services will satisfy the agency's needs.

B-C

1&2

RESPONSE: FAR 6.302-1(a) contains the statutory citations and language required by Public Law 98-369. Said language includes the condition "...and no other type of supplies or services will satisfy agency requirements." FAR 6.301(b) requires the contracting officer to insert the specific statutory authority (U.S. Code citation) applicable. It is this test that the contracting officer must satisfy before commencing negotiations without having provided for full and open competition.

2. (FAR 6.302-1(b)(2)&(3)). The treatment of follow-on contracts and unsolicited proposals --listed as the second and third examples, respectively, under the first exception -- is equally troubling. As currently written, these examples do not limit the sole-source award in either case to the conditions specified in CICA. Since the proposed regulations state that the list of examples is "not intended to be all inclusive," a contracting office may attempt to justify a sole-source award of follow-on contracts or unsolicited proposals unrelated to the specified conditions, which is not authorized under CICA.

B&C&I

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RESPONSE: Concur. The coverage will be clarified to ensure that unsolicited research proposals and follow-on contracts must comply with the conditions specified in the statute. The language will be modified to further clarify the specific authority available under 6.302-1 (including all statutory parameters associated therewith).

3. (FAR 6.302-1(b) and 6.303-1(c)). The remainder of examples under the first exception seek to create broad categories for sole-source award which are not authorized under CICA. Determinations and decisions required to use this exception are to be made on a case-by-case basis pursuant to the criteria provided. See related problem with FAR 6.303-1(c).

B&C

1&2

RESPONSE: 6.302-1(b): **The examples are not provided to broaden the statute but rather to make more clear the limitations of the statute and to be helpful to the contracting officer. The examples are not authorities in and of themselves, but are merely situations in which the authority of 6.302-1(a) may be used.**

ATTACHMENT #1

6.303-1(c): We concur that the wording under this subpart may lead one to conclude that a contracting officer does not need to review each contracting action on a case-by-case basis. Therefore, we will change this subpart to require the contracting officer to ensure, on a case-by-case basis, that each contract action taken pursuant to the authority of a Class Justification and Approval is within the scope of the J&A and the contracting officer shall document the contract file accordingly.

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4. **(FAR 6.302-1(b)(2)).** The FAR provisions do not reflect our intent, as expressed on page 1426 of the Conference Report, that noncompetitive follow-on contracts are to be limited to those awarded after (1) an original competitive award and (2) a cost-benefit analysis is conducted to determine and document whether the initial capital investment could cause substantial duplication of cost if the contract were awarded to other than the original source, or whether such cost could be offset by savings resulting from competition.

RESPONSE: Provided that all elements of the law are met ("...award to a source other than the original source would result in (i) substantial duplication of cost to the United States which is not expected to be recovered through competition, or (ii) unacceptable delays in fulfilling the agency's needs,..."), the contracting circumstances of the original award should not be the determinative factor. The history of an acquisition, i.e., whether the original award was competitive or non-competitive, cannot be changed (although all original awards resulting from solicitations issued on or after 1 April 1985 must comply with P.L. 98-369.) To limit follow-on acquisitions to only those which occur after a competitive original award does not give recognition to the objective contracting situation at the time of the follow-on procurement and could prove damaging to fulfillment of the agency's mission, including increased cost and unacceptable delays. FAR 6.303-2(a)(9)(ii) further addresses the documentation requirements for follow-on contracts.

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5. **(FAR 6.302-1(c)(2)).** FAR 6.302-1(c)(2) provides that for contracts awarded under the first exception, the notices required by FAR 5.201 "shall have been published and any bids or proposals must have been considered." The FAR, does not, however, provide additional guidance regarding what constitutes "consideration." The Conference Report states on page 1427 that "agencies should at a minimum, give each bid or proposal...sufficient consideration so as to be able to make an informed judgment about the responsibility of the bidder and the responsiveness of the bid."

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RESPONSE: Formal bids or proposals are generally not solicited by public notices (synopses) but by subsequent solicitations. This is to

assure that all prospective offerors are equally aware of all of the Government's requirements (the basis for award, etc.) which cannot all be addressed in the synopsis. As currently stated in Note 22 of the Commerce Business Daily (required by FAR 5.207(d)(3) to be cited in synopses announcing an intended sole source award), information received as a result of the notice (synopsis) will be considered for the purpose of determining whether to conduct a competitive procurement.

FAR 15.402(g) further requires that, if the contracting officer determines, after consideration of responses to a synopsis citing the authority of FAR 6.302-1, that more than one source can meet the Government's needs, the contracting officer shall then issue a competitive solicitation and shall comply with FAR Part 5 synopsis requirements (i.e., a new synopsis would normally be published). The determinative process required by FAR 15.402(g) would involve consideration of the overall potential of a prospective offeror to meet the Government's needs, as expressed in the information submitted by prospective offerors in response to this type of synopsis. Formal determinations of responsiveness and responsibility are made based upon proposals or bids submitted in response to formal solicitations.

6. (FAR 6.303). Under CICA, an executive agency may not "procure property or services from another executive agency unless such other executive agency complies fully with the requirements of this title." This provision is included, according to page 1428 of the Conference Report, "to prevent one agency from acquiring its goods and services from another agency's sole-source contract without having to justify a non-competitive procurement itself." FAR 6.303, which covers the justification requirements for using procedures other than competitive procedures, should incorporate that provision.

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RESPONSE: The concern expressed in this comment is covered under FAR 6.002, "Limitations," which states, "No agency shall contract for supplies or services from another agency for the purpose of avoiding the requirement of this part."

7. (FAR 6.303-1(c)). FAR 6.303-1(c) permits justifications relating to the first six exceptions from competitive procedures to be made on a class basis. Again, this provision runs contrary to our stated intent that "all determinations and decisions required for use of the exceptions to competitive procedures...are to be made on a case-by-case basis. Broad categories or classes of products and services cannot be exempt from competitive procedures." See page 1427 of the Conference Report.

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RESPONSE: As stated in our response to Comment 3 above, the regulation will be revised to ensure that each individual acquisition based on a class justification is within the scope of the class justification

previously approved. Each individual contract action will be reviewed through this process to ensure that it complies with CICA.

8. **(FAR Part 7).** FAR Part 7 deals with acquisition planning. The predominant emphasis seems to be on acquisition planning for relatively complex or high-dollar procurements. We believe that this part should be revised to provide guidance for other than complex or high dollar procurements. The Conference Report states on page 1429 that the planning requirements in CICA apply to all procurements -- competitive and noncompetitive.

S

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RESPONSE: Concur. We are looking at improving FAR Part 7 in this regard. FAR Part 7 is not intended to predominantly emphasize acquisition planning for relatively complex or high-dollar procurements. Under FAR 7.103, it is the responsibility of the agency head or designee to prescribe procedures "establishing criteria and thresholds at which increasingly greater detail and formality in the planning process is required as the acquisition becomes more complex and costly, specifying those cases in which a written plan shall be prepared." Part 7 recognizes that certain acquisitions may require more detailed and formal planning than other acquisitions, but does not negate the statutory requirements for acquisition planning. This is also reflected in the definition of "acquisition planning" in FAR 7.101 which is: "the process by which the efforts of all personnel responsible for an acquisition are coordinated and integrated through a comprehensive plan for fulfilling the agency need in a timely manner and at reasonable cost. It includes developing the overall strategy for managing the acquisition." (Emphasis added.)

9. **(FAR 10.002(b)).** FAR 10.002(b) requires that defense agencies include descriptions of agency requirements, whenever practicable, to be stated in terms of functions to be performed or performance required. This preference for functional or performance specifications over detailed design specifications is applicable government-wide, rather than just to defense agencies.

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RESPONSE: Concur. Although it is not required by statute for civilian agencies, paragraph 10.002(b) will be rewritten to require it by regulation.

10. **(FAR 13.000(a) & 13.103(a)).** FAR 13.000(a) provides for a $10,000 small purchase threshold for civilian agencies, which was increased to $25,000 under the Office of Federal Procurement Policy Act Amendments of 1983 (P.L. 98-191). Below this threshold, FAR 13.103(a) states that small purchase procedures shall be used to the maximum extent practicable. This provision fails to emphasize CICA's requirement that "in using small purchase procedures, an executive agency shall promote competition to the maximum extent practicable." The regulation should reflect that requirement.

Dropped from Final Report

RESPONSE: Concur. FAC 84-5 reflected the $25,000 small purchase threshold in FAR 13.000. FAC 84-5 also provided, under FAR 13.106(b), Purchases over $1,000, "(c)ontracting officers shall solicit quotations from a reasonable number of sources to promote competition to the maximum extent practicable..." (13.106(b)(1)).

11. **(FAR 15.804-2(a)(2)).** FAR 15.804-2(a)(2) states that there are "relatively few instances" where certified cost or pricing data and inclusion of defective pricing clauses would be justified in awards between $25,000 and $100,000. While certified cost or pricing data are not required for negotiated contracts under $100,000, contracting officers are authorized under CICA to obtain such data and should not be discouraged from doing so, especially considering the spare parts problems.

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RESPONSE: These words have been in the regulations for some time and were not affected by CICA. Contracting officers are not precluded from obtaining cost or pricing data where such data are determined necessary.

12. **(FAR 15.804-2(a)(2)).** For contracts under $25,000, moreover, FAR 15.804-2(a)(2) states that "the contracting officer shall not require certified cost or pricing data." This prohibition simply has no basis in statute.

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RESPONSE: The limitation in FAR 15.804-2(a)(2) is designed to avoid the expense to the Government associated with requiring certification of cost or pricing data on small dollar value contract actions. This limitation on requiring certification is consistent with CICA amendments to 41 U.S.C. 254 and 10 U.S.C 2306 which afford agency heads discretionary authority concerning requiring cost or pricing data submission on actions below $100,000. It is also consistent with CICA language which encourages agencies to establish simplified procedures with respect to purchases of $25,000 or less. On such actions, contracting officers may and do obtain cost or pricing data (uncertified) where necessary to determine the reasonableness of the price offered.

13. **(FAR Subpart 15.5).** FAR 15.5, which deals with unsolicited proposals, needs to be revised to (1) limit noncompetitively awarded unsolicited proposals to those involving research, (2) define or provide guidance for applying the concept of "unique" referred to in 15.502, 15.503(c)(1), 15.560-2(a)(1), 15.507(a)(3), etc., and (3) place limitations on information that may be disclosed to only one or a few select potential contractors when others could also meet the agency's needs.

Dropped
in Final
Report

RESPONSE: Concur in part. In order to clarify that only unsolicited research proposals may be processed to a non-competitive award using the traditional procedures of FAR 15.5 (and previously in DAR 4-900) in accordance with P.L. 98-369, the coverage will be modified to more specifically address unsolicited research proposals. The coverage currently in FAR Subpart 15.5 complies with P.L. 98-369 and, in addition, recognizes that there are non-research "unsolicited" proposals that are submitted (as well as unsolicited research proposals not meeting the criteria in P.L. 98-369 and FAR 15.503(c)) and provides guidance to contracting officers on the requirements for handling these actions (at FAR 15.507) that essentially directs them to comply with FAR Parts 5 and 6. This coverage will, however, be modified to clarify that unsolicited proposals other than valid unsolicited research proposals may not be processed under the abbreviated procedure authorized by P.L. 98-369 as implemented at FAR 6.302-1(b)(3). Since the term "unique" is not given any special meaning in the law or regulation different than its normally understood definition, additional guidance concerning this term is not deemed necessary or appropriate.

14. (FAR 19.502-2). FAR 19.502-2 retains the "Rule of Two" provision, which we believe is no longer appropriate under CICA. The minimal standard for competition established by the "Rule of Two" provision runs contrary to section 16 of the Office of Federal Procurement Policy Act, as amended by CICA, which requires agencies "to increase the use of full and open competition...by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or proposals from responsive sources..." The Conference Report clearly states on page 1434 that this requirement applies to "all agency procurements, including those made under set-aside programs."

Dropped in Final Report.

RESPONSE: We do not interpret the "Rule of Two" to be in conflict with CICA. Use of the rule contemplates full and open competition after a set aside decision has been made.

15. (FAR 4.6). The FAR does not incorporate the record requirements in CICA, which amend section 19 of the Office of Federal Procurement Policy Act. These provisions are required to be implemented on a government-wide basis.

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RESPONSE: For the Department of Defense, DD Form 350, for NASA, Form 507, and for the civilian agencies, Standard Form 279 were all revised to comply with Section 19 of CICA. Information required by CICA is being collected by each executive agency on these forms and entered in the Federal Procurement Data System on a Government-wide basis.

16. **(P.L. 98-577 and 98-525).** Finally, the proposed FAR changes, of course, need to be revised in accordance with the provisions of P.L. 98-577 and P.L. 98-525.

A

RESPONSE: Concur. P.L. 98-525 and P.L. 98-577 amendments to CICA were implemented in FAC 84-5 (updated synopsis provisions) and FAC 84-6 (revised public comment provisions).

17. **(FAR 5.002).** FAR 5.002 (page 12). Suggest deleting the phrase "offering competitive opportunities for contractors and subcontractors." This phrase has been widely interpreted by contracting officials as requiring publicizing of contract actions only when they decide that competitive opportunities exist. (See GAO/PLRD-82-40, especially pages 30 and 31.)

RESPONSE: Concur. The quoted words will be deleted. The introductory phrase of FAR 5.002 as amended, will read: "Contracting officers shall publicize contract actions in order to..."

Dropped in FR

18. **(FAR 5.202(a)(1)).** FAR 5.202(a)(1) (page 13). Suggest revision to provide for the exception when "the synopsis for a contract action cannot be worded to preclude the disclosure of information which would compromise the national security. The fact that a contract action involves classified information does not, in itself, justify an exception."

H
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RESPONSE: The language used is in compliance with P.L. 98-577. Any release of classified information in the CBD would compromise the national security. The decision to classify information (to avoid compromise of the national security) is made by individuals other than the contracting officer and is not reviewable by the contracting officer. Although the language of 5.202(a)(1) will be modified to more closely conform to P.L. 98-577, guidance concerning release of classified information is deemed necessary for understandable application of the regulation by contracting officers, and is not intended to broaden the use of the statutory exception in any way. The proposed coverage is as follows:

> **The synopsis cannot be worded to preclude disclosure of an agency's needs and such disclosure would compromise the national security (e.g., would result in disclosure of classified information). The fact that a proposed solicitation or contract action contains classified information, or that access to classified matter may be necessary to submit a proposal or perform the contract does not, in itself, justify use of this exception to synopsis.**

19. **(FAR 5.202(a)(7)).** FAR 5.202(a)(7) (page 13) needs clarification. Do the last four lines apply to proposals under SBIDA, too?

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RESPONSE: Concur that clarification is required. The last four lines, regarding uniqueness and disclosure issues, were not meant to apply to SBIDA proposals. We will separate FAR 5.202(a)(7) into two items and renumber remaining items.

20. **(FAR 5.203(c)).** FAR 5.203(c) (page 14). Suggest the words "unilateral sole-source" be eliminated.

Dropped in FR

RESPONSE: The words "unilateral sole-source" orders under a basic ordering agreement are included in FAR 5.203(c) to cover a specialized type of acquisition. Synopses for orders other than unilateral sole source orders are addressed elsewhere in FAR 5.203. This is a case where the regulatory implementation attempts to capture as large a number of contract actions as possible. However, in view of this and other comments regarding these words we will consider further whether revision is necessary.

21. **(FAR 5.301).** FAR 5.301, line 4 (page 16). Suggest adding "any" before the word "subcontracts," per CICA, section 2732, amending section 18(a)(1)(B) of the OFPP Act.

Dropped in FR

RESPONSE: Concur. The coverage will be amended to clarify that contract awards over $25,000 must be synopsized if any subcontracts are likely.

22. **(FAR 6.003).** FAR 6.003 (page 19). Suggest revising the definition of full and open competition by adding the words "submit sealed bids or competitive proposals and" before the word "compete."

Dropped FR

RESPONSE: The suggested language is too restrictive because under CICA there are other competitive procedures which are available in addition to sealed bids and competitive proposals as indicated in FAR 6.102, Use of competitive procedures.

23. **(FAR 6.303-2(a)(6) or 6.303-2(a)(8)).** FAR 6.303-2(a)(6) or (8) (page 23). Suggest adding at the end of this provision such words as, "including whether a CBD notice was publicized as required by FAR 5.2 and, if not, which exception under 5.202 applies." Otherwise, when publication of a CBD notice is not mentioned in the justification, reviewers will not know from reading it whether such notice was publicized.

Dropped in FR

RESPONSE: Concur. We will add the suggested words to 6.303-2(a)(6).

24. **(FAR 6.303-2(9)(ii), line 2.)** FAR 6.303-2(9)(ii), line 2 (page 23). Suggest adding "to the government" after "cost." (See FAR 6.302-1(b)(2) and CICA sections 2711 and 2723(d)(1)(B).)

Dropped in FR

RESPONSE: Concur. The words "to the Government" will be added after "cost."

25. **(FAR 6.304(a)(1)).** FAR 6.304(a)(1) (page 23). Suggest that the floor (i.e., the lowest dollar amount) to which this requirement applies, presumably $25,000, also be cited.

Dropped in FR

RESPONSE: FAR Part 6 applies to all acquisitions with certain exceptions. One exception (see FAR 6.001(a)) is contracts awarded using the small purchase procedures of Part 13. As stated in Part 13, small purchase procedures are to be used to the maximum extent practicable for all purchases of supplies or services not exceeding the small purchase limitation ($25,000). When small purchase procedures are used, the acquisition is already outside Part 6 and, therefore, stating a dollar floor would be superfluous. However, when small purchase procedures are not used, there is no dollar limitation and Part 6 applies regardless of the dollar value of the acquisition. Nevertheless, in view of this and other comments regarding FAR 6.304, we will consider whether revision is appropriate.

26. **(FAR 7.101).** FAR 7.101 (page 25, definition of market survey). It is not clear how the phrase "and the results of any market test recently undertaken" fits in. Suggest wording clarification.

Dropped in FR

RESPONSE: The phrase in question appears in the definition of "market survey" contained in FAR 7.101. The phrase is included in the definition as an example of the type of testing of the marketplace which may occur. The policy statement in FAR 7.102 requires that agencies conduct market surveys in order to promote and provide for full and open competition. In addition, each justification for the use of other than full and open competition is required under FAR 6.303-2 to include a description of the market survey conducted and the results. Therefore, if a market test had recently been undertaken, this fact and the results of the test would have to be included in the justification.

27. **(FAR 8.403-2).** FAR 8.403-2 (page 3). Contained a FAR revision adding a new second sentence, "All responsible offerors may submit offers in response to a solicitation for multiple-award schedule contracts." But the FAR instructions deleted this revision. Suggest that this revision be retained. (See CICA section 2711 amending FPASA section 309(b)(3) and CICA section 2721 amending 10 U.S.C. 2302(2)(C).) It is not clear why this revision was deleted.

Dropped in FR

RESPONSE: Part 8 of the FAR addresses only use of schedules (i.e., requirements for ordering activities). FAR Part 38 addresses development of schedules. The language cited is found at FAR 38.102-2(a).

28. **(FAR 9.2 and FAR Part 11 - P.L. 98-577 and 98-525).** Has FAR 9.2 (pages 34 and 35, revised) and FAR Part 11 (starting on page 39, revised) been revised to be consistent with Public Law 98-577 and, to the extent appropriate, the DoD fiscal year 1985 authorization act?

Dropped in FR

RESPONSE: Revised provisions for qualification requirements and commercial pricing for supplies appear in FAC 84-11 and 84-10 respectively.

29. **(FAR 10.002(a)(4)).** FAR 10.002(a)(4) (page 37). Obviously, something is missing here.

Dropped in FR

RESPONSE: Concur. The missing coverage was corrected and included in FAC 84-5 as enumerations (i), (ii) and (iii) under FAR 10.002(a)(4).

30. **(FAR 13.103(b)).** FAR 13.103(b), last line (page 42). Suggest "the use of" replace the words "negotiation under."

Dropped in FR

RESPONSE: Concur. The suggested wording will be adopted in the revised CICA coverage.

31. **(FAR 13.204(c)).** FAR 13.204(c) (page 45), revised). Suggest the proposed FAR revision be deleted. The earlier wording appears to be more appropriate.

Dropped in FR

RESPONSE: It is our view that use of the current wording, "purchasing from only one source," is broader and therefore preferable to the narrower wording, "sole source purchasing", since any non-competitive action is discouraged.

32. **(FAR 14.101(e)).** FAR 14.101(e) (page 49). Suggest the "and" before "other factors included" be deleted.

Dropped in FR

RESPONSE: Concur. FAC 84-5, paragraph 14.101(e) made the recommended change.

33. **(FAR 14.103-2).** FAR 14.103-2 (page 49). Suggest "unless" be added after sealed bidding.

Dropped in FR

RESPONSE: Concur. FAC 84-5, paragraph 14.103-2 made the recommended change.

34. **(FAR 14.104 and 14.501).** FAR 14.104, line 2 (page 49). Suggest changing "formal advertising" to "sealed bidding." Also see FAR 14.501, line 2 (page 65).

Dropped in FR

RESPONSE: Concur. FAC 84-5 made the recommended change to both FAR citations.

35. **(FAR 14.201-7(b)(1)).** FAR 14.201-7(b)(1), line 1 (page 52). Suggest adding "sealed bidding" after "by."

RESPONSE: Concur. FAC 84-5, paragraph 14.201-7(b)(1) made the recommended change.

36. We could not find some of the information in FAR references. For example:

-- **(FAR 14.203-1).** (page 55) refers to 5.102(c)(1).

RESPONSE: Concur. FAC 84-5 corrected the reference to read "5.102."

-- **(FAR 14.404-1(e)(1)).** (page 59) refers to 15.103, which is "reserved."

RESPONSE: FAR 15.103 is no longer reserved, its title as printed in FAC 84-5 is now, "Converting from Sealed Bidding to Negotiation Procedures." The reference in FAR 14.404-1(e)(1) to 15.103 is correct.

-- **(FAR 36.103(a)).** (page 143, revised) refers to 6.003(a) and 6.003(b)(2).

RESPONSE: Concur. FAC 84-5 corrected the references in 36.103(a) to read 6.401(a) and 6.401(b)(2) respectively.

-- **(FAR 36.601).** (page 147, revised) refers to 6.102(c)(1).

RESPONSE: Concur. FAC 84-5 corrected the reference in 36.601 to read 6.102(d)(1).

-- **(FAR Subpart 38.1).** (page 150, revised) shows a paragraph (c) to be inserted (but it does not indicate where). The insert refers to FAR 6.103.

RESPONSE: Proposed paragraph (c) in the 1 October 1984 draft became paragraph 38.102-2(c) in FAC 84-5 and the reference therein was corrected to read 6.102(d)(3).

37. **(FAR 15.502).** FAR 15.502 (page 75). FAR policy only addresses unsolicited research proposals, but the definition of unsolicited

proposal is not limited to research. (Also, see comment number 1 on page 1 and comment number 11 on page 9, above.)

RESPONSE: Please see our response to Comment 13, above.

38. **(FAR 15.503(c)(5)).** FAR 15.503(c)(5) (page 75). The meaning of "documented" is unclear. Will this wording permit noncompetitive awards simply because known requirements were not "documented" in some specific way defined by agencies' internal procedures?

Dropped in FR

RESPONSE: FAR 15.507(a)(2)) was changed to reflect CICA language that unsolicited proposals should not be accepted if they resemble the substance of pending procurement requests. However, we will review the language in 15.503(c)(5) to determine if a revision is necessary.

39. **(FAR 15.1001(a)).** FAR 15.1001(a) (page 96). Suggest adding the word "promptly" before "notify." (See CICA, section 2711 amending FPASA section 303B(d)(4) and CICA section 2723 amending ASPA section 2305(b)(4)(D).)

Dropped in FR

RESPONSE: Concur. The word will be added.

40. **(FAR 17.6).** Should FAR 17.6 be revised based on CICA? For example, see 17.604(c).

Dropped in FR

RESPONSE: In accordance with its terms (FAR 17.602(a)) Subpart 17.6 limits use of these procedures to agencies specifically authorized by statute to enter into management and operating contracts. FAR 17.6 will be revised as necessary to clarify that CICA (Part 6) applies to such contracts.

41. **(FAR 19.502-4(a)).** FAR 19.502-4(a) (page 114). Suggest "Whenever possible" be changed to "Whenever appropriate."

Dropped in FR

RESPONSE: Partially concur. To avoid possible misunderstandings between "possible" and "appropriate," we decided that neither phrase should appear in FAC 84-5 and we therefore deleted the words "whenever possible."

42. **FAR 34.002(b) and 34.005-1(a)).** FAR 34.002(b) and FAR 35.005-1(a) (page 139). Suggest that the references to "effective" competition be deleted (while retaining the references to Part 6 and full and open competition).

Dropped in FR

RESPONSE: We do not agree that it would be beneficial to delete the references to "effective" competition. Effective competition is result oriented and exists when competitive market forces result in the lowest cost alternative to the Government or the best technical

design meeting the Government's minimum needs. Because the present coverage uses the terms "effective" competition and "full and open" competition conjunctively, both requirements are applicable in major system acquisition.

43. **(FAR 44.302(a)).** FAR 44.302(a) (page 153) deletes some wording relating to modifications. It is not clear why.

Dropped in FR

RESPONSE: The proposed coverage which was originally disseminated for public comment deleted the words "and modifications to competitively awarded contracts and formally advertised contracts." FAC 84-5 later added back in the words "and modifications" so that the dollar value of modifications (other than those when the negotiated price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or is set by law or regulation) will be included in the contractor's business base when determining whether a contractor purchasing system review (CPSR) is to be conducted. The proposed coverage deleted too many words.

44. **(FAR Part 52, Table of Contents).** FAR Part 52, table of contents, item 52.214-3 (page 162). Why is "Invitations for Bids" changed to "Request for Sealed Bids?"

Dropped in FR

RESPONSE: The change of "Invitation for Bids" to "Request for Sealed Bids" was not intended and was included inadvertently. This change was considered, but was later rejected as unnecessary and an undue implementation burden on the federal procurement community (the myriad of references to this form at all levels and the changes to the forms themselves).

Responses to 19 July 1985 Letter

1. (FAR 4.6). Although FAR 4.6 has not been revised, it refers to the "FPDS manual;" but the new Federal Procurement Data Center (FPDC) instruction implementing CICA does not revise the manual.

Dropped in F.R

RESPONSE: For the Department of Defense, DD Form 350, for NASA, Form 507 and for the civilian agencies, Standard Form 279, were all revised to comply with Section 19 of CICA. Information required by CICA is being collected by each executive agency on these forms and entered in the Federal Procurement Data System on a Government-wide basis. Although revision to the Federal Procurement Data Center's operating procedures and manuals is not a matter within the cognizance of the FAR system, your concerns have been transmitted to the Federal Procurement Data Center for necessary action.

2. (FAR 4.6). The new instruction relating to the Federal Procurement Data System (FPDS) form calls for reporting (1) one offer and (2) more than one offer; but "responsible" is not mentioned.

Dropped in F.R

RESPONSE: Assuming an agency uses competitive procedures and receives only one offer, the contract awarded to the sole offeror would be awarded to the "one responsible source." The information required by Section 19(c) is therefore being provided even though "responsible" is not specifically mentioned in implementing agency procedures. FPDS procedures are not, in any event, within the cognizance of the FAR System.

3. (FAR 4.6). The 5-year retention period is not mentioned in the FAR, FPDS manual, or FPDC instruction.

M
/2

RESPONSE: Since instructions for retention of records by the Federal Procurement Data Center is the responsibility of that Center, such instructions should therefore properly be included in FPDC manuals or operating instructions rather than in the FAR.

4. (FAR 5.207(b)(4)). FAR mentions QPL but not "offeror" qualification requirements.

L
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RESPONSE: Concur. FAR 5.207(b)(4) will be revised to reflect the requirements of P.L. 98-577 that the synopsis contain a provision that reflects whether the solicitation requires that an offeror, its product, or service must meet a qualification requirement in order to be eligible for award, and that further identifies the office from which additional information about the qualification requirement may be obtained.

ATTACHMENT #2

5. **(FAR 5.202(a)(1)).** Should the FAR (Commerce Business Daily (CBD) notice) exception be rewritten to conform to the statute (national security exception)?

Dropped in FR

RESPONSE: Concur. See our response to Comment 18, Attachment #1.

6. **(FAR 5.202(a)(7)).** Should the FAR (CBD notice) exception include (at the end): "or would disclose proprietary information associated with the proposal"?

Dropped in FR

RESPONSE: Concur. The exception at 5.202(a)(7) will be divided into two exceptions -- one dealing with P.L. 97-219 actions and the other addressing unsolicited research proposals. The words suggested will be added to the end of the latter exception.

7. **(FAR 5.201(b) and 5.205(c)(2)).** What is the legal basis for generally exempting from the CBD notice requirement all proposed contract actions to be made outside "the U.S., its possessions or Puerto Rico" (5.201(b)) as well as architect - engineering services specifically (5.205(c)(2)?

K
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RESPONSE: The authority for the use of this language is Section 18(c)(3) of the OFPP Act and 15 U.S.C. 637(g)(3), (Section 8 of the Small Business Act as amended by P.L. 98-577).

Prior to passage of P.L. 98-369 (CICA), the same language, which was in the FAR and all predecessor federal procurement regulations (FPR, DAR/ASPR) was authorized by language in the Small Business Act (15 U.S.C. 637(e)). In the development of FAR coverage implementing P.L. 98-369 by the DAR Council and CAA Council, prior to enactment of P.L. 98-577, the Councils were faced with two differing laws addressing public notice requirements (15 U.S.C. 637(e) and Section 18 of the OFPP Act). The new OFPP Act coverage did not contain the language "...from any Federal department, establishment, or agency engaged in procurement of supplies and services in the United States..." (emphasis added), but authorized an exception where the head of an agency determines in writing that it is not appropriate or reasonable to publish a notice before issuing a solicitation and obtains concurrence from the Administrator, OFPP. On behalf of the FAR System and the participating agencies thereunder, the Director of the DAR Council and the Chairman of the CAA Council prepared such a determination and forwarded it to the Administrator, OFPP. On 26 September 1984, Mr. Donald E. Sowle responded: "I concur in the above request to exempt from synopsis in the CBD proposed contract actions by agencies engaged in procurement outside the United States and for utility services when only one source is available."

Later, when P.L. 98-577 was enacted, it was not immediately recognized by the Councils that the enabling language of the Small Business Act had been removed. Subsequently however, it was

determined that "consultation" (the replacement for "concurrence" inserted by P.L. 98-577) had been achieved informally by the Chairman, CAA Council, and due to the fact that the SBA is represented on the CAA Council.

In general, the determination recognized, consistent with longstanding practice, that synopsis of proposed contract actions to be entered into and performed outside the United States generally serves no useful purpose, would unduly delay such contract actions (due to the waiting periods), and would confuse U.S. firms. Current practice in our overseas contracting offices is to synopsize all contract actions where U.S. sources are desired to participate. In DoD contracting activities overseas, nearly all requirements for supplies are sent to the U.S. for procurement action and normal synopsis practices are followed. Generally, it is services, subsistence and construction that are contracted for locally.

The regulation will be revised to clarify the specific overseas situations when synopsis is not required (e.g., awarded and performed overseas, only local sources will be solicited). It should be recognized that full and open competition and competitive procedures are still required to be used (except where one of the circumstances of FAR 6.302 must be applied).

8. (FAR 6.302-1(b)(4)). The FAR example covers the first half of the CICA exception to competition but not the second: "no other type of property or services will satisfy the needs of the executive agency." C 2

RESPONSE: Please see our response to Comments 1 and 3 within Attachment #1.

9. (FAR 15.804-2(a)(1)(ii)&(iv)). Shouldn't the FAR contain the following provision after "$100,000": "or such lesser amount as may be prescribed by the agency head"? Q 15

RESPONSE: In this regard, the discretion afforded the agency head by CICA to require certified cost or pricing data in contract actions below $100,000 has been implemented within FAR 15.804-2(a)(2), which allows contracting officers to obtain such data when appropriate.

10. (FAR 15.1001(a)). Does this FAR provision conflict with CICA? CICA's bid protest provisions and the fact that notice to unsuccessful offerors often provides a basis for protests increase the importance of such notice. P 14

RESPONSE: Concur. The exceptions to the requirement for notifications to unsuccessful offerors were inadvertently retained in this provision. Appropriate changes will be made when the final rule is promulgated.

Mr. **Mitchell**. What response, if any, did you receive from those two committees? That is for all three of the witnesses.

Ms. **Leftwich**. I do not believe we received any response directly from the committee, sir.

Mr. **Mitchell**. There was no response, to the best of your recollection?

Ms. **Leftwich**. To the best of my recollection.

Mr. **Mitchell**. Mr. Evans.

Admiral **Evans**. No, sir; I received none.

Mr. **Mitchell**. Ms. Szervo? No?

Ms. **Szervo**. No.

Mr. **Mitchell**. To the best of your knowledge, did the former Administrator of OFPP, Donald Sowle, send a similar letter?

Admiral **Evans**. Yes; he did, Mr. Chairman.

Mr. **Mitchell**. He did? Do either of you have a copy of that letter?

Admiral **Evans**. Yes, Mr. Chairman.

Mr. **Mitchell**. I would like a copy of his letter to be made an official part of the record.

Admiral **Evans**. It is a letter, dated May 30, 1984, addressed to the Honorable Jack Brooks.

Mr. **Mitchell**. Could you read that letter? Is it very long?

Admiral **Evans**. It is about 3½ pages, sir.

Mr. **Mitchell**. What is the bottom line in that letter?

Admiral **Evans**. The last paragraph states:

> Both the FPR and the DAR provisions of total set-asides were considered to be reasonable implementations of the Small Business Act and supported by the Comptroller-General. The FAR ultimately settled on the Rule of Two or More versus sufficient number criteria which is consistent with the Small Business Act which requires a fair proportion of the total Federal procurement to be awarded to small businesses. I hope this information is useful to you.

Mr. **Mitchell**. Thank you.

Admiral **Evans**. Prior to that, he summarizes the positions of the three agencies in the letter.

Mr. **Mitchell**. I would ask that that be made a part of the official record of this hearing.

[Letter referred to above, follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

May 30, 1984

Honorable Jack Brooks
Chairman
Committee on Government Operations
2157 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

This is in further response to your letter of March 14, 1984 concerning the "rule of two or more" contained in the Federal Acquisition Regulation (FAR 19.502-2).

Mr. Stockman's interim response of April 4, 1984 indicated that we had requested additional information from the three regulatory agencies, DOD, GSA, and NASA. Having received their responses and coordinated with the Small Business Administration, we are able to provide information on the points in your March 14 letter: 1) that FAR 19.502-2 is in violation of law, 2) your request for an explanation of how FAR 19.502-2 came to be included in the regulation and at whose request, and 3) your recommendation that action be taken to remove these provisions from the FAR.

1) Your letter states that small business total set-aside provisions are in violation of current law. Your letter states that, "It is inherently unfair to turn over the Federal marketplace to any single economic group," indicates that your concern is with those situations where virtually all of the Government's requirements for certain products or services are set-aside for small business. We understand this concern but its cause does not lie with the "rule of two or more." The application of the "rule of two or more" or the "sufficient number" standard for determining the extent of small business competition would not normally change the situation where all Federal requirements in a particular industry sector are set-aside for small business. These situations occur when there are many small businesses in an industry sector and the decision to set aside would most often be the same using either standard. The agencies have reported substantial competition in the small business set-aside program with an average of ten or more competitors on each procurement. Therefore, the issue is not the method of determining the existence of adequate competition among small businesses, but rather, should the situation be allowed to continue which results in all Federal requirements for particular products or services being set-aside for small business?

The Small Business Act (15 USC 644) has long been held to authorize the use of set-aside procurement method for any contract (or part of a contract) whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns...." (Underlining added.) The rule of two or more only comes into play after any of the foregoing four considerations have been satisfied and the FAR merely continues that policy.

The key to this issue is that "fair proportion" is tied to total purchases and contracts made by the Government. Since the bulk of Federal expenditures are for major systems which, at the prime contract level, are unavailable to small business, implementation of the Small Business Act requirement that a fair proportion of the total Government contracts be placed with small business practically dictates that disproportionate shares must be awarded outside of the major systems area. We believe the FAR language complies with current law and reflects the will of the Congress as expressed in the Small Business Act. This method of implementing the fair proportion of total contracts has been upheld by the Courts.

2) In response to the second point raised in your letter, we note that this change was a result of the established FAR drafting, public comment, and review procedures. In this case, the FPR and the DAR contained different provisions. The FPR version, which contained the "sufficient number" standard, was initially published for comment. Five of the six comments (including those of DOD, GSA, NASA and SBA) received on this provision requested that the language be amended to include the more specific criteria for determining if small business competition is available (i.e., "rule of two or more"). The sixth comment requested added language to the effect that the set-aside would not impair agency mission or program requirements. Because of prior inconsistent application by contracting officers in the civil agencies of the "sufficient number" standard, and because the rule of two or more has worked well in DOD for more than five years as well as in NASA, the three regulatory agencies decided, in the executive review phase, that the most workable standard for total set-aside in implementing the Small Business Act was the rule of two. Responses from DOD, GSA and NASA confirmed this view.

3) We totally concur that the major purpose of procurement is to serve agency missions in a cost-effective manner. However, there are curently a large number of non-procurement related public policies (socio-economic goals) implemented through the Federal procurement process. Although the procurement community consistently points out the burden imposed by these policies, we recognize that a balance must be struck between pure business management efficiencies and fairness in contracting and the attainment of these public policies established by law. Under Section 7 of P.L. 98-191, "Tests of Innovative Procurement Methods and Procedures," we have begun to work with the agencies to identify potential areas for study. These issues could surface as potential candidates for study.

Both the FPR and DAR provisions on total set-aside were considered to be reasonable implementations of the Small Business Act and have been supported by the Comptroller General. The FAR ultimately settled on the "rule of two or more" vs. "sufficient number" criteria which is consistent with the Small Business Act and which requires a fair proportion of total Federal procurement be awarded to small business. I hope this information will be useful. If I can be of further assistance, please let me know.

Sincerely,

Don Sowle

Donald E. Sowle
Administrator

Mr. Mitchell. By letters dated March 4, our former colleague, Representative Addabbo, and Mr. Bedell, Mr. Mavroules, and myself, informed the Secretary of the Department of Defense and the Administrators of GSA and NASA of our interpretation of CICA as it pertains to the Rule of Two.

I would like copies of our letter to be made an official part of the record.

[Letter follows:]

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DAVID DREIER, CALIFORNIA
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MAJORITY—225-5821
MINORITY—225-4038

AREA CODE 202

March 4, 1986

Honorable Caspar W. Weinberger
Secretary
Department of Defense
The Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

This Committee has received a copy of a February 21, 1986 memorandum authored by David F. Baker, Acting Administrator of the Office of Federal Procurement Policy (OFPP), and addressed to the Secretary of Defense and the Administrators of the National Aeronautics and Space Administration (NASA) and the General Services Administration (GSA). This memorandum purports to exercise OFPP's authority pursuant to 41 U.S.C. section 405, as implemented by OFPP Letter 85-1. The subject of the memorandum is the "Small Business Set-Aside Determination Provisions of FAR."

We have reviewed the memorandum and, for the reasons stated below, do not believe it was issued "with due regard for applicable laws and the program activities of the executive agencies" (41 U.S.C. section 405(a)). Accordingly, we recommend that DoD, NASA, and GSA delay any requested publication until the issue of OFPP compliance with the statute is resolved by the President.

OFPP claims that the subject memorandum is required by section 2733 of the Competition in Contracting Act of 1984 (CICA). That provision amended section 16(1) of the OFPP Act to read as follows:

> "To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

Reading this statutory provision OFPP has concluded that:

(1) the so-called "rule of two" found in section 19.502 of the FAR should be repealed;

(2) a set-aside cannot take place unless the contracting officer demonstrates that a sufficient number of responsible small business concerns "will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost ...";

(3) a class set-aside cannot take place unless the contracting officer makes a written determination that the demonstration referred to in (2) "can be achieved on each procurement in that class, evaluating in detail ... quality, timeliness and cost factors"; and

(4) a repetitive set-aside cannot take place unless the contracting officer makes a written determination reaffirming that small business will submit the lowest reasonable cost.

OFPP's extreme interpretation is in contradiction with the clear meaning of relevant provisions of the CICA.

As you know, CICA amended, among other things, both the Federal Property and Administrative Services Act (FPASA) and, what is commonly referred to as the Armed Services Procurement Act (ASPA). For the sake of this discussion, we shall refer only to sections of the FPASA since CICA amends both statutes with identical provisions in the area here relevant.

Section 303(a) of FPASA generally requires that agencies obtain full and open competition through the use of competitive procedures. Subsection (b) of this same section, as amended by P.L. 98-577 (October 30, 1984), authorizes agencies to use competitive procedures but to exclude a specific source or, in the case of small business set-asides, to exclude all sources other than small business concerns.

Section 309(b) of FPASA, as amended by P.L. 98-577, defines competitive procedures as including small business set-asides "as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete."

Reading sections 303 and 309 together, it is clear that small business set-asides are to be deemed as full and open competition using competitive procedures provided that the buying agency does not limit the number of eligible small businesses that may submit an offer in response to a set-aside solicitation.

The provision cited by OFPP as requiring its proposed rule change (section 2733 of CICA, 42 U.S.C. section 414(1)), is a direction to Federal agency heads that, when implementing the FAR, they not adopt internal policies, procedures and practices that would unnecessarily restrict the number of otherwise eligible sources that could compete for the award. It is our impression that such unnecessary inhibitors to full and open competition may, in particular circumstances, include bonding requirements, restrictive specifications, geographic limitations, directed subcontracting sources, and other definitive elements of responsibility not justifiable in

light of the particular agency need in question. Such restrictions would, of course, militate against the use of full and open competition and its concomitant benefit of lowering costs. Our interpretation is fully consistent with sections 303 and 309 of the FPASA which preclude an agency from limiting the number of eligible small businesses that may compete for a set-aside. Indeed, if such a limitation would occur, that procurement would no longer be deemed full and open competition.

The "rule of two" has nothing whatsoever to do with a limitation on the number of eligible competing sources. The rule is applied prospectively (before the requirement is synopsized) by a contracting officer to determine whether a procurement should be set-aside -- not whether an eligible small business should be precluded from submitting an offer.

Aside from the fact that the proposed regulation is not required by CICA, the regulation, if adopted, would also have a detrimental effect on the Federal acquisition process. By way of illustration, consider the following:

(1) How can a contracting officer equitably administer a "lowest reasonable cost" standard when the particular acquisition in question may be awarded under source selection criteria that subordinate cost to technical merit?

(2) Can the "lowest reasonable cost" standard ever be met if a large business indicates an interest in submitting an offer?

(3) In those relatively few instances when the contracting officer can demonstrate that only small business will submit proposals and, therefore, that the "lowest reasonable cost" test will be satisfied, are not set-asides rendered meaningless since the awards will be made to small business regardless of the procurement strategy used? Is it reasonable for OFPP to assume that Congress intended to render the set-aside authority a practical nullity through the strained construction of a statutory provision that does not even mention set-asides?

(4) Why does CICA require "a reasonable expectation of receiving more than one sealed bid" as the standard for a sealed bid procurement (section 2711(a)(1)), but, as interpreted by OFPP, require a more stringent standard for small business set-asides?

(5) How can an agency expect its program activities to expand competition and the mobilization base (see section 15(a) of the Small Business Act) if it cannot limit the concentration of contracts through the use of set-asides?

(6) Would adoption of the regulation set a precedent that the Administrator of OFPP has the authority to implement -- through memoranda -- the responsibilities reserved to agency heads under 41 U.S.C. section 414?

We fully understand that certain buying agencies have experienced difficulties with set-asides in some industrial areas because of faulty size standards adopted by the Small Business Administration (SBA). However, we believe the solution to that problem is size standard reform, not the effective elimination of set-asides.

For the reasons cited above, we again urge that publication of the proposal be indefinitely delayed so that DoD, NASA, and GSA have an opportunity to present their positions on these most important issues directly to the President.

If you should have any questions regarding this letter, please have a member of your staff contact our Committee's Legislative Counsel, Tom Trimboli, at 225-4351.

Sincerely,

Joseph P. Addabbo, M.C.

Parren J. Mitchell
Chairman

Berkley Bedell, M.C.

Nicholas Mavroules
Chairman, Subcommittee on General
Oversight and the Economy

PJM:ttf

cc: Norma Leftwich, Director
Office of Small & Disadvantaged Business
Utilization, Department of Defense

John Wynn, Director
Office of Small & Disadvantaged Business
Utilization, General Services Administration

Eugene Rosen, Director
Office of Small & Disadvantaged Business
Utilization, National Aeronautics and
Space Administration

Mr. **Mitchell**. From your testimony this morning, I guess I am correct in assuming that you are in general agreement with the position that we took in our correspondence with regard to the Rule of Two?

Admiral **Evans**. Yes, I am.

Mr. **Mitchell**. I think that is probably self-evident.

I have a number of other questions. I am going to let my colleagues raise some questions, and then I might be able to ask one or two more that I want to put to you.

Congressman Hayes, do you have questions at this point?

Mr. **Hayes**. I do not have any questions, Mr. Chairman.

I just want to commend the witnesses for taking this stance which you have done in support of the Rule of Two program, which I think is an integral part of the set-aside program, which is so necessary if SBA is to function as it should and benefit those who it purports to help.

Thank you very much.

Mr. **Mitchell**. Thank you.

Congressman Gallo.

Mr. **Gallo**. Thank you, Mr. Chairman.

You have indicated that you have notified a number of the committees, Government Operations and Government Affairs on the Senate side, I believe.

Do you normally get a response back?

Ms. **Spector**. It depends. Sometimes we do. Not always.

Mr. **Gallo**. In this particular case, were you expecting a response?

Ms. **Spector**. Not necessarily.

Mr. **Gallo**. Your letter to OMB and the chairman indicated you are going to supply us with copies of those letters, is that correct?

Mr. **Mitchell**. Yes. We have them now.

Mr. **Gallo**. OK. Did you get a response from them? You indicated that you disagreed with the——

Ms. **Spector**. I am not sure.

Mr. **Gallo** [continuing]. May 22.

Ms. **Spector**. There was a letter of March 26 that was sent over saying that we declined to publish; the response to that was evidently their publication on May 22 in the Federal Register. We did not get a specific response to that one. There was a letter from Secretary Weinberger to which there was a response.

Mr. **Gallo**. I see.

Mr. Chairman, with all the controversy on this, I am a little surprised that the committees did not respond in an affirmative way, indicating that they concurred or at least gave some indication as to their feelings.

I have not been here that long. I do not know whether that was something that normally happens, no response, or whether this was unusual to this particular fact.

Mr. **Mitchell**. Would you yield briefly to me?

Mr. **Gallo**. Yes.

Mr. **Mitchell**. We, as Members of Congress, I know, try to reply to every piece of correspondence we receive. I just do not think you can run a shop, be it in Congress or outside of Congress, in an efficient manner if you send a letter and there is no response at all. I, too, am concerned about the failure of the committees involved to respond in writing.

Mr. GALLO. Thank you.

Mr. MITCHELL. Congressman Ireland, do you have some questions?

Mr. IRELAND. No, Mr. Chairman.

Mr. MITCHELL. Mr. Evans, in your testimony you refer to the old sufficient number test and how that test resulted in inconsistent interpretations throughout the agency.

As bad as that was, is the OMB proposal not even more dangerous?

OMB is suggesting that the contracting officer must demonstrate that a sufficient number of responsible small business concerns will respond at the lowest reasonable cost.

Now, before you respond to me, I just want to lay out my feelings. I think this is a radical departure from the old sufficient numbers test that predated FAR. In my opinion, how does a contracting officer know before advertising a contract whether a small business will submit the lowest cost? With that background, would you try to evaluate the proposed change in terms of the further inconsistent interpretations and even the more dangerous kind of way of handling this situation?

Admiral EVANS. I would defer to my procurement specialists, and I would defer to my contracting officers. I have discussed it with my procurement people on various occasions, from the standpoint of asking for their position if this reverts to a sufficient number.

As I said previously, to change from something that has been fairly well established and is clear and definitive, to a different term, an undefined term, sufficient number, does introduce confusion, and does introduce the type of thing that I think we were attempting to avoid when we published the Federal Acquisition Regulation, and that is unclear guidance. Sufficient number is not clear guidance.

It does, as I mentioned before, place an additional burden on them. One alternative to doing this would be to perhaps synopsize your intent as a matter of information in the Commerce Business Daily early to find out what measure of response you get from small businesses before you make that final decision.

Mr. MITCHELL. Yes.

Admiral EVANS. We have discussed this in some manner with the Commerce Business Daily, and I think they are reluctant to publish that type of information, saying that they have more than they can handle. It is a useful way of determining availability of sources and we have used that upon several occasions with success.

I do not believe from our past practice, and we have examined this, that the Rule of Two or More has led to anything other than reasonable prices. Generally, we have a price history of what we buy. That is examined, and the contracting officer always has the responsibility to determine if the price is fair and reasonable.

And even if a set-aside does not produce that, he still has the responsibility to make that judgment and if the prices are quite inconsistent, then he has a means to take care of it. We have not had that experience.

Mr. MITCHELL. All right. Thank you.

Let me just comment here that it is appallingly clear to me that we have a situation in which almost a unilateral decision was made without consultation, without the necessary interfacing with all the people involved. Under the questioning directed by Mr. Gallo, it was made clear that there was no prior consultation with SBA before this was done.

To the best of my knowledge, I do not think there was any consultation at all with the small business community that would be directly affected by this decision, by this proposed rule. I am distressed because with all of our shortcomings in the Congress, we, when we have hearings like this, attempt to get opinions from everyone.

We have almost endless hearings to make sure that all persons affected by a proposed legislation have an opportunity to speak their piece. It just appears to me that this was a unilateral decision made without any real consultation.

Ms. Leftwich, the Department of Defense adopted the Rule of Two in 1979, and according to your statement, set-aside awards as a percent up to total awards remained approximately 25 to 30 percent from 1970 to 1979, if I recall correctly?

Ms. LEFTWICH. I believe that is correct.

Mr. MITCHELL. Then, after the Rule of Two was adopted, it moved from 30 percent to 35 percent in 1980, 46 percent in 1981, 49 percent in 1982, 51 percent in 1983, 52 percent in 1984, and 53 percent in 1985.

Now, my first inclination is to assume that the Rule of Two facilitated that increased participation on the part of small business. I am just assuming that, but in order to make it very clear, were there any other significant changes in your small business procurement regulations during that time, when we saw an acceleration of small business participation? Any other than the adoption of the Rule of Two?

Ms. LEFTWICH. Other than certainly the adoption of Public Law 95-507, which gave certain authorizations to set-asides and certain other areas, and certainly, in general, strengthened the entire small business program and caused us to expand our regulations.

Mr. MITCHELL. I have a copy of your letter, Ms. Spector, dated March 26, and you informed the then Acting OFPP Administrator, David Baker, of the decision not to publish the OFPP memorandum of March 21.

Based on your letter, which is kind of in conflict with your testimony or some of the testimony we have heard, based on your letter, it seems to me you are saying that while the OFPP memo violates the policy of OFPP 85-1, you are not going to publish it because of anticipated criticism of small business supporters in the Congress.

I guess I was one of them.

Ms. SPECTOR. What I was saying in this letter is that we were not advocating a change. I have gone on record saying that a year earlier. We were not advocating the change, and OMB was, so we believed they should publish the change and given the anticipated level of comment, we would not know what to do with those comments. Presumably, many would be negative, and since they were advocating the change, they should do it.

Now, as far as the procedures, as was mentioned by Mr. Swain earlier, they had gone out under the procedures where they were changing the FAR. That was not quite what they were supposed to do. They can, however, make policy for procurement as we have all said, and, indeed, they can do that. They were almost citing the wrong paragraph of their authority. That was the minor point we made there.

Mr. MITCHELL. All right. One last bit of dialog from me.

I am a very independent sort of person. I like to make decisions and move on them. However, I have never assumed that any decision I made would be bereft of consultation, nor have I ever assumed that I am the sole arbiter, sole controller of decisions affecting people.

Yet, we have a peculiar situation in which three well-respected agencies clearly delineated their position with regard to this procedure change, and it appears that OMB arbitrarily defined itself as the sole arbitrator in this situation.

I will close it out by saying that when I first started talking this morning I said that one of the great benefits of our system is checks and balances. In this instance, I greatly fear that there were no checks and balances in terms of consultation, and I also greatly fear that this Nation is going to be severely damaged somewhere down the line if the opinions of three respected agencies are blithely brushed aside in a capricious manner.

Thank you very much for your testimony.

Our final panel consists of Mr. Joseph Wright, the Deputy Director of the Office of Management and Budget; Mr. David Baker, the Acting Administrator of the Office of Federal Procurement Policy; and Mr. William S. Coleman, the Associate Administrator for Procurement Law and Legislation in the Office of Federal Procurement Policy.

Thank you, gentlemen, for being here.

We have copies of the statements, and I would appreciate it if you would attempt to summarize your statement. I do not want to cut you off, but it would be helpful if you could do that.

Mr. Wright.

TESTIMONY OF JOSEPH R. WRIGHT, JR., DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. WRIGHT. Thank you, Mr. Chairman.

I will submit my testimony for the record per your suggestion, but I would like to add a few points, if I may.

Mr. MITCHELL. Sure.

Mr. WRIGHT. As we start out our testimony, first of all, we are delighted to appear and testify before this committee, although we have been saying that it is going to be rather tough testimony.

The reason is very simple: There has been a lot of controversy, as you have heard, among the agencies within the administration and within the Congress.

As far as we look upon it, this action was not capricious or taken quickly by any means. As a matter of fact, I am really surprised to some extent that the Congress did not insist on faster action because the Competition and Contracting Act was passed more than 2 years ago.

Government Affairs in the Senate and Government Operations in the House are our particular oversight committees, and to be honest with you, between yourself and myself, Mr. Chairman, I am very surprised that they allowed us to go through the extensive deliberations that have occurred, by the way, and which were not really properly presented, I do not think, to this committee by all of the witnesses.

This has been 2 years of going back with agency comment, coming back to the Office of Management and Budget, going back up for very specific instructions as best we could from the oversight committees of both the Senate and the House, and with a strong legal interpretation that we had spent 2 years trying to resolve this issue and we are not following up on the law as was written by the Congress of the United States.

Now, from our standpoint, I have heard that this is an OMB position. Mr. Chairman, is it not an OMB position per se with exceptions of the legal interpretation of what was required by the legislation?

Now, we did not write that law. The Congress wrote that law, and what we were doing is following up over a long period of time as best we could to follow that law, and that is exactly what our position has been.

Now, I would only close by saying that we have bent over backward trying to get not only again what was the intent in the Competition in Contracting Act as regards the Rule of Two, but specifically did, because the oversight committees had responsibility for drafting that legislation, want us to take this action, specifically, and the answer was unquestionably yes.

Now, if that is a problem in the Congress of the United States, and you need clarifying language for whatever you want to do in terms of maintaining the Rule of Two, I respectfully disagree with one of the prior witnesses. I think that is a problem for the Congress to resolve.

Again, you wrote the law. We did not, but we did interpret and we did get explanations as to what was intended, and we got very specific instructions.

Thank you, sir.

[See appendix A, for correspondence and exhibits.]

[Mr. Wright's prepared statement follows:]

PREPARED STATEMENT OF JOSEPH R. WRIGHT, JR., DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here to discuss our proposal to modify the Federal Acquisition Regulation regarding small business set-aside determinations and I would like to make one thing very clear to the Subcommittee: this issue has been pending for over two years since the Competition in Contracting Act was passed and OMB's role has been one of enforcing the law -- which is one of our responsibilities.

The reason for the delay has been because of the extra precautions we have taken to try to resolve legal disputes and obtain confirmation of Congressional intent.

You asked that I address my comments to several specific aspects of the process by which we decided to go forward with repeal of the "rule of two".

With regard to correspondence between my office and the Congress on the subject, copies of that material have been provided to the Subcommittee. As far as the solicitation of information from the Congress is concerned, I did request clarification of Congressional interest regarding the intended effects of the Competition in Contracting Act on the "rule of two". Those requests were directed to the Government Operations Committee, the principal House Committee sponsor of the CICA.

With regard to my activities in this matter, as Deputy Director of OMB, my efforts throughout this controversy have been aimed at finding a solution that would reflect the will of the Congress, as provided in the Competition in Contracting Act, and this Administration. Early this year, I concluded - based on two years of staff deliberation and the views of key members of the two sponsoring committees of CICA - that the "rule of two" should be repealed. I communicated that conclusion to David Baker through staff of the OMB General Counsel's Office, with the request that the necessary documents be prepared.

This is the first exercise of OFPP's authority to issue a regulatory change when the three regulatory agencies decline to follow OFPP's direction. I should also point out that this was the first occasion in which it was necessary to invoke OFPP's new regulatory authority, which was provided in 1983. It's unfortunate that this authority had to be exercised on such a controversial subject -- but, again, it was the law.

OMB did not engage in formal consultation with the regulatory agencies regarding their interpretation of the effects of CICA. Many informal discussions occurred through the OFPP staff for over two years and in our view the statute and the intent of the sponsoring committees is very clear.

That concludes my formal statement Mr. Chairman. I will be pleased to respond to any questions you or your colleagues may have.

Mr. MITCHELL. Thank you.

In your statement, you say that in an attempt to ascertain——

Mr. WRIGHT. Pardon me, Mr. Chairman. Do you want the other two witnesses to make whatever——

Mr. MITCHELL. Yes.

Mr. Baker, would you like to make a statement?

TESTIMONY OF DAVID F. BAKER, ACTING ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

Mr. BAKER. I am David Baker, Acting Administrator for Federal Procurement Policy. Mr. Chairman, it is a pleasure for me to be here this morning to discuss our draft proposal to modify the Federal Acquisition Regulation regarding small business set-aside determinations.

As you requested, I will keep my statement brief.

Our proposal, which would replace the current Rule of Two formula with a sufficient number standard, was published on May 22, 1986, for a 60-day public and agency comment period. This action was the culmination of a lengthy deliberation regarding the proper interpretation and implementation of the Competition in Contracting Act of 1984.

In February, following nearly 2 years of staff consideration, we concluded that the intent of CICA as reflected in the statute itself, its legislative history, and the views of the principal committee sponsors in both the Senate and the House, was that the Rule of Two be replaced by a variation of the formula which had previously been employed by civil agencies and, prior to that, for many years, by the Defense agencies.

In your invitation, Mr. Chairman, you asked that I respond to five specific areas of inquiry. The first item requested that we provide copies of all documents from congressional sources relating to the Rule of Two and the effects of CICA.

We have examined the OFPP files for the last 2 years and have located 37 letters from 31 Members of Congress. Copies of all of these letters as well as our responses to them have been provided to the subcommittee.

[See appendix B for letters referred to above.]

Mr. BAKER. Similarly, we have provided copies to the subcommittee of all documents in OFPP's files "from any person in the employ of OMB" relating to this issue.

You also asked for a detailed description of the circumstances surrounding publication of the May 22 notice and whether it was initiated by OFPP. I have appended a lengthy chronology to my statement, Mr. Chairman, that traces the history of this controversy since OFPP became involved in it over 2 years ago. It also reflects my involvement since being appointed acting administrator in January of this year.

But with specific regard to the May 22 notice, the principal circumstances are these: Upon learning of the decision of the regulatory agencies on March 26, 1986, that they would not issue the draft regulatory change as requested by my office, I informed the Deputy Director of OMB of the agencies' decision. Upon discussion and further consideration, we concluded in mid-April that the most appropriate action would be to directly invoke OFPP's regulatory authority to implement CICA.

Regarding the third item, you asked for a description of OFPP's analysis regarding our conclusion that there would be no significant impact upon a substantial number of small entities under the Regulatory Flexibility Act.

With the subcommittee's permission, I will defer to Mr. Coleman on that matter.

You also asked, however, if anyone in the employ of OMB directed us to so certify. The answer, Mr. Chairman, is no.

With regard to the fourth item, I am not aware that legal opinions were requested from SBA, DOD, GSA, or NASA on CICA requirements for repeal of the Rule of Two at any point during the last 2 years.

There has been, however, a substantial amount of consultation by OFPP with the agencies and others on this issue since 1984.

You asked if we consulted with SBA prior to publication of our October 1984 notice in the Federal Register regarding the Rule of Two. Our files do not reveal any such consultation.

Last, you also asked regarding the negative responses to that notice, what percentage was from firms obviously in excess of the small business size standards. Of the approximately 200 commenters, nearly 130 opposed retention of the Rule of Two. It was not possible, however, from reading the letters to determine the relative size of those responding firms.

That concludes my statement, Mr. Chairman. I will be happy to respond to any questions.

[Mr. Baker's prepared statement follows:]

PREPARED STATEMENT OF DAVID F. BAKER, ACTING ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Subcommittee--

I am pleased to be here this morning to discuss our draft proposal to modify the Federal Acquisition Regulation regarding small business set-aside determinations. Our proposal, which would replace the current "rule of two" formula with the "sufficient number" standard, was published on May 22, 1986 for a sixty day public and agency comment period. A copy of the Federal Register notice is attached to the statement I have provided to the Subcommittee.

This action was the culmination of a lengthy deliberation within OFPP and OMB regarding the proper interpretation and implementation of the Competition in Contracting Act (CICA) of 1984. In February, following nearly two years of staff consideration, we concluded that the intent of CICA, as reflected in the statute itself, its legislative history and the views of the principal committee sponsors in both the Senate and the House, was that the "rule of two" be replaced by a variation of the formula which had previously been employed by civil agencies for many years and, prior to that, by defense agencies. That formula provides that contracting officers would set aside a procurement or class of procurements for small business when a "sufficient number" of bids from small businesses would result in the "lowest reasonable cost."

In your invitation, Mr. Chairman, you asked that we address five items of information relating to this issue.

The first item requested that we provide copies of all documents from Congressional sources relating to the "rule of two" and the effects of CICA. We have examined the OFPP files for the last two years, and have located 37 letters from 31 Members of Congress. The majority of these communications were simply constituent referrals or requests for information. Several, however, including letters from Congressmen Brooks, Horton, Aspin, Hefner, and Edwards, as well as Senators Cohen and Levin recommended either repeal of the "rule of two" or publication for comment of the proposed replacement rule. Similarly, there were letters, including ones from members of this Committee as well as Congressman Florio and Senators Sasser and Dixon, urging that the "rule of two" be retained. Copies of all of these letters, as well as our responses to them, have been provided to the Subcommittee.

With regard to documents "from any person within the employ of OMB," I have been advised by the OMB General Counsel to respectfully decline to provide such materials as exist to the Committee. They are documents prepared in connection with the development of an Administration position on the effects of the Competition in Contracting Act on the "rule of two" and, as such, constitute internal deliberative materials of the Executive Branch. I am prepared, of course, to testify about any discussions I have had regarding this issue.

You asked for a detailed description of the circumstances surrounding publication of the May 22nd notice and whether it was initiated by OFPP. I have appended a lengthy chronology to my statement, Mr. Chairman, that traces the history of this controversy since OFPP became involved in it over two years ago. It also reflects my involvement since being appointed Acting Administrator in January of this year. But with specific regard to the May 22nd notice, the principal circumstances are these. Upon learning of the decision of the regulatory agencies on March 26, 1986, that they would not issue the draft regulatory change as requested by my Office on February 21st, I informed the Deputy Director of OMB of the agencies' decision. Upon discussion and further consideration, we concluded in mid-April that the most appropriate action would be to directly invoke OFPP's regulatory authority to implement CICA. This was a decision jointly arrived at, reflecting the next logical step in the course of action that had been adopted in February. The notice was prepared in OFPP, was coordinated throughout the affected elements of OMB during April and May, and approved by the Director of OMB. It was signed by me on May 15th and forwarded to the Federal Register.

On the third item, you asked for a description of OFPP's analysis regarding our conclusion that there would be no significant impact upon a substantial number of small entities under the "Regulatory Flexibility Act." With the Subcommittee's permission, I will defer to Mr. Coleman on that matter. You also asked, however, if anyone in the employ of OMB directed us to so certify. The answer is no. OMB regulations require that, as a routine matter, proposed rules of this nature indicate the applicability of the Regulatory Flexibility Act, but there was no specific direction received in this instance as to the wording of the certification. In answer to your further question, SBA was not consulted during the preparation of this notice, although a copy of it was subsequently provided to that agency.

With regard to the fourth item, I am not aware that legal opinions were requested from SBA, DOD, GSA, or NASA on CICA requirements for repeal of the "rule of two" at any point during the past two years. There has been, however, a substantial amount of consultation by OFPP with the agencies and others on this issue since 1984, and we have been aware for some time that the agencies' views in this matter were at variance with ours.

Lastly, you asked if we consulted with SBA prior to publication of our October, 1984 notice in the Federal Register regarding the "rule of two." Our files do not reveal evidence of such consultation. You also asked, regarding the negative responses to that notice, what percentage was from firms obviously in excess of the small business size standards. Of the approximately 200 commenters, nearly 130 opposed retention of the "rule of two." It is not possible, however, from reading the letters to determine the relative size of the responding firms.

This has been a controversial and contentious issue, Mr. Chairman, and one about which, we believe, honest persons can sincerely disagree. But we believe the course we are taking does reflect a reasonable interpretation of the law and responsible exercise of OFPP authority.

That concludes my opening statement, Mr. Chairman. I will endeavor to respond to any questions you or your colleagues may have.

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Parts 6 and 19

Federal Acquisition Regulation; Small Business Set-Aside Determinations (Rule of Two)

AGENCY: Office of Federal Procurement Policy (OFPP), OMB.

ACTION: Proposed rule.

SUMMARY: OFPP is requesting comments on a proposed change to the Federal Acquisition Regulation (FAR) on Small Business Set-Aside Determinations to implement provisions of the Competition in Contracting Act of 1984 (Pub. L. 98-369).

DATE: Comments are due on or before July 21, 1986.

ADDRESS: All interested parties are invited to comment on this proposed regulation change. Comments should be forwarded to William S. Coleman, Jr., Office of Federal Procurement Policy, OMB, 726 Jackson Place, NW., Washington, DC 20503 on or before July 21, 1986. Mr. Coleman may be contacted by phone on (202) 395-3501.

FOR FURTHER INFORMATION CONTACT: William S. Coleman, Jr., Office of Federal Procurement Policy, OMB, 726 Jackson Place, NW., Washington, DC 20503, (202-395-3501).

SUPPLEMENTARY INFORMATION:

A. Background

Prior to the Federal Acquisition Regulation (FAR), the Federal Procurement Regulation (FPR) and the Defense Acquisition Regulation (DAR) contained different criteria for making a total small business set-aside determination.

The DAR provided that if ". . . there is a reasonable expectation that (i) offers will be obtained from *at least two* responsible small business concerns offering the products of different small business concerns and (ii) awards will be made *at reasonable prices* . . ." a set-aside shall be made. (Emphasis added)

The FPR provide that ". . . there must be a reasonable expectation that bids or proposals will be obtained from a *sufficent number* of responsible concerns, organizations, and individuals so that awards will be made *at reasonable prices*." (Emphasis added)

When the small business section of the FAR was first published for public comment (July 1982), it contained the FPR "sufficient number" standard. Comments received supported a change to the DAR "rule of two" standard. Accordingly, when the final version of the FAR was published on April 1, 1984, it contained the "rule of two" standard.

In July 1984, following the issuance of the FAR, the Competition in Contracting Act of 1984 (CICA) was passed by Congress and signed into law by the President. The CICA contained the following requirement (section 2732):

> ". . . the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a *sufficient number* of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the *lowest reasonable cost* considering the nature of the property or service procured." (Emphasis added).

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, *including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added:)*

On February 21, 1986, OFPP submitted a proposed regulation to the Department of Defense, General Services Administration, and the National Aeronautics and Space Administration, and directed that it be published in the **Federal Register** for a 30-day comment period. The purpose of the regulation was to replace the "rule of two" criteria now in the FAR with the "sufficient number" criteria specified in the above provision of the Competition in Contracting Act. On March 29, 1986, the Deputy Assistant Secretary of Defense for Procurement advised OFPP that DOD, GSA, and NASA had concluded that ". . . since you have been the proponent of the change, it would be preferable for you to publish the policy directly." Accordingly, pursuant to the authorities granted in section 6 of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. 401, et seq.), notice is hereby given that DOD, GSA, and NASA have failed to issue regulations in a timely manner and it is OFPP's intent to prescribe the following proposed regulation in the FAR due consideration of all comments received in response hereto.

B. Regulatory Flexibility Act

The proposed revision of FAR Parts 6 and 19 is not expected to have a significant impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601, et seq.).

Adoption of the "sufficient number/lower reasonable cost" formula should not reduce the number of small business set-asides. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Business Act. The regulations will still continue to require that contracting officers review acquisitions to determine if they can be set-aside and will still provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Contracting officials will still evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will also continue to review the purchase history of the item or service to determine if it has previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DOD's utilization of the "rule of two" commenced only about 5 years before the FAR.

Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond than large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (Pub. L. 98-369, the

Competition in Contracting Act of 1984, and Pub. L. 98–577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business would be substantially lower than that proposed by small business would a set-aside be cancelled. This is the case under current regulations as well.

C. Paperwork Reduction Act

The Paperwork Reduction Act (Pub. L. 96–511) does not apply because the proposed changes to FAR Parts 6 and 19 do not impose any additional reporting or recordkeeping requirements or collection of information form offerors, contractors, or members of the public which require the approval of OMB under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Parts 6 and 19

Government procurement.

It is proposed to amend 48 CFR Parts 6 and 19 as follows:

1. The authority citation for Parts 6 and 19 continues to read as follows:

Authority: 40 U.S.C. 486(c); Chapter 137, 10 U.S.C.; and 42 U.S.C. 2453(c).

PART 6—COMPETITION REQUIREMENTS

2. Section 6.101 is amended by adding paragraph (c) to read as follows:

6.101 Policy

* * * * *

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19—SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

3. Section 19.501 is amended by revising paragraph (g) to read as follows:

19.501 General.

* * * * *

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

* * * * *

4. Section 19.502–2 is revised to read as follows:

19.502–2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-aside, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history or an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

David F. Baker,
Acting Administrator.

Dated: May 15, 1986.

[FR Doc. 86–11534 Filed 5–21–86; 8:45 am]

BILLING CODE 3110-01-M

CHRONOLOGY OF MAJOR EVENTS AND CORRESPONDENCE SURROUNDING THE RULE OF TWO ISSUE

Date	Action or Event
March 14, 1984	Letter from Congressman Brooks to David Stockman, Director, OMB recommending that action be taken to remove the "rule of two" provisions from the Federal Acquisition Regulation (FAR) before they become effective on April 1, 1984.
April 1, 1984	The FAR becomes effective, including Part 19 which provides that the "rule of two", previously employed by the Department of Defense, is now the Government-wide formula for making small business set-aside determinations, replacing the "sufficient number" standard employed by civil agencies. (This was a judgement made by the FAR councils, and was not published for public comment.)
May 10, 1984	Letter from Congressman Horton to Director Stockman referring to a press release issued by Congressman Addabbo in support of the "rule of two." Horton reaffirmed his and Chairman Brook's opposition to the rule and asked when OMB was going to act.
June 4, 1984	Administrator Sowle replied to Congressman Horton's May 10th letter and advised that the FAR conformed to the Small Business Act.
July 18, 1984	Enactment of the Competition in Contracting Act of 1984 which called on agency heads to increase full and open competition by issuing regulations assuring that a "sufficient number" of bids or proposals are received to fill requirements at the "lowest reasonable cost," including requirements filled through set-aside programs.
October 12, 1984	OFPP solicited views on the "rule of two," as already set forth in Part 19 of the Federal Acquisition Regulation, since these provisions were not publicized for comment immediately prior to the effective date of the FAR.
October 18, 1984	Letter from Congressman Mitchell to Administrator of OFPP, Donald Sowle. Letter stated that OFPP did not consult with SBA before publishing October 12, 1984, Federal Register notice and generally opposed any changes to the "rule of two."

October 31, 1984	Letter from OFPP Administrator, Donald Sowle, replying to Congressman Mitchell's October 18, 1984, letter. Mr. Sowle's letter explained that public comment on "rule of two" was solicited because the FAR was implemented without such comments being obtained.
November 13, 1984	Congressmen Parren Mitchell and Berkely Bedell wrote to OFPP Administrator, Donald Sowle and expressed their dismay over any proposed change to the procedure for making set-asides. Copies of all correspondence between OFPP and members of Congress on "rule of two" were requested.
November 29, 1984	Letter from Donald Sowle, Administrator, OFPP responding to Messrs. Mitchell and Bedell's November 13, 1984 letter. Mr. Sowle's letter extended comment period on OFPP's Federal Register notice an addition of 30 days and requested clarification of Congressional intent on CICA provisions from Congress.
December 7, 1984	Letter from Congressman Mitchell to OFPP Administrator, Donald Sowle.
December 12, 1984	Letter to Mary Ann Gilleece (DoD Procurement head) cosigned by Senators Cohen and Levin and Congressmen Brooks and Horton indicating concern that several aspects of CICA had not yet been reflected in the FAR, and stating a conclusion of the GAO that "Part 19 . . . retains the 'rule of two' which we believe is no longer appropriate under CICA."
December 29, 1984	Letter from OFPP Administrator, Sowle, to Congressman Mitchell advising that confusion and controversy existed regarding "rule of two" and a meeting between respective staffs might be in order.
January 4, 1985	Letter from Congressman James J. Florio to William Mathis, Acting Administrator, OFPP opposing repeal of "rule of two."
January 14, 1985	Mr. Mathis, Acting Administrator, OFPP, replied to Congressman Florio's January 4, 1985, letter and advised that "requirements of Small Business Act" would be considered in OFPP's review of "rule of two" issue.
March 4, 1985	Meeting in Deputy Director Wright's office at which all aspects of the issue were discussed.
April 1, 1985	CICA becomes effective

April 3, 1985	OFPP completed analysis of comments resulting from October 12th solicitation of views on "rule of two". Results: of 199 comments, 72 supported the rule (mostly small and minority business) and 127 opposed it (mostly architect/engineer firms.)
July 17, 1985	Executive Committee on Federal Procurement Reform meeting. (The Executive Committee is composed of senior procurement officials from DoD, GSA, NASA, Agriculture, VA, DoE, DoT and Interior as well as representatives from SBA and OPM.) The Executive Committee was thoroughly briefed by the OFPP staff on the "rule of two" controversy.
July 19, 1985	Letter to David Stockman, Director, OMB from Congressmen Brooks and Horton indicating that since the regulatory agencies had not acted as a result of the December 12, 1984, letter, OFPP should take immediate action to correct the problems identified in the earlier correspondence.
August 7, 1985	Federal Procurement Council Meeting. The Federal Procurement Council consist of senior procurement representatives from 24 major agencies and departments. The Council was briefed by the OFPP staff on the "rule of two" issue at this meeting.
August 20, 1985	Interim reply to Congressmen Brooks and Horton from Fred Upton, Deputy Assistant Director, Legislative Affairs, OMB. Mr. Upton's letter advised that further information was being requested from DoD, GSA and NASA and a more complete response to the July 19th letter would be provided at a later date.
September 9, 1985	Letter from Fred Upton, to Congressmen Brooks and Horton advising that DoD, GSA and NASA had appeared, with certain exceptions, to bring the FAR into compliance with CICA.
December 20, 1985	Letter to Deputy Director Wright, cosigned by Congressmen Brooks and Horton, urging replacement of "rule of two" with regulations complying with the CICA.
January 10, 1986	OMB's General Counsel's office notified OFPP that Deputy Director Wright had decided to issue the necessary directives/instructions to repeal "rule of two."

February 5, 1986	Federal Procurement Council advised by Acting Administrator, OFPP that Administration intended to change from "rule of two" to "sufficient number" standard.
February 10, 1986	OFPP started proposed instruction through the OMB coordination process.
February 21, 1986	Issuance of memoranda by Acting Administrator for OFPP to Defense, GSA and NASA requesting that action be initiated to replace the "rule of two" with the "sufficient number" formula, as required by the CICA. First step: to publish the proposed change within 30 days for a 30-day comment period.
March 2, 1986	Letter from Chairman Hefner and Congressman Edwards of the Subcommittee on Military Construction of the House Committee on Appropriations to Deputy Director Wright urging repeal of the "rule of two" regulations.
March 5, 1986	Letter from Deputy Director Wright to Congressmen Brooks and Horton responding to their joint letter of 12/20/85. The response advised that 3 procuring agencies had been directed to publish proposed rule for comment.
March 10, 1986	Letter from Congressmen Brooks and Horton responding to Deputy Director Wright's March 5, 1986, letter. The Congressmen complimented Mr. Wright on conforming the FAR to requirements of CICA.
March 10, 1986	Senator Sasser wrote to OMB Director, James Miller opposing OMB's proposed change to the "rule of two."
March 21, 1986	Eleanor Spector (Senior DoD Procurement Official) called OFPP and indicated that agencies would decline to issue the change to the FAR, proposing instead that OFPP do so.
March 25 1986	Meeting in Deputy Director Wright's office attended by OMB staff members to discuss "rule of two" developments. Conclusion: notify Congressman Brooks of agencies' intransigence, draft OFPP proposed regulation.
March 25, 1986	OMB's Associate Director for Legislative Affairs, Bryce Harlow, replied to Senator Sasser's March 10th letter to explain OMB's rationale for changing "rule of two."
March 26, 1986	Letter from Eleanor Spector (DoD Procurement) sent to Acting Administrator, OFPP indicating reluctance of regulatory agencies to comply with OFPP's February 21st direction to publish the replacement FAR language for comment.

April 1, 1986	Senator Alan J. Dixon wrote David Baker, Acting OFPP Administrator advising that CICA did not require the repeal of the "rule of two."
April 2, 1986	Letter to Chairman Brooks apprising him of action on the part of regulatory agencies declining to comply with OFPP direction of February 21, 1986.
April 6, 1986	Letter from Secretary Weinberger to Director, OMB requesting that he ask OFPP to reconsider the repeal action since the "rule of two is the only way of assuring that sizeable small business goals will be met." (OMB's response of May 7th, restated the statutory need for repeal and noted Congressional support for repeal.)
April 10, 1986	Mr. Baker, Acting OFPP Administrator, advised Senator Dixon in reply to the Senator's April 1st, letter that in OFPP's view CICA required the adoption of the "sufficient number" standard.
April 15, 1986	Letter from Congressman Aspin, sent to Director OMB recommending OFPP publication for comment of the replacement language to the "rule of two."
April 18, 1986	Letter from Chairman Brooks and Congressman Horton urging OMB to go ahead and issue the regulation repealing the "rule of two" on OFPP's authority.
May 7, 1986	Federal Procurement Council briefed by Acting Administrator, OFPP that OFPP was planning to exercise its regulatory authority to replace "rule of two" with "sufficient number".
May 15, 1986	Federal Register notice signed by Acting Administrator, OFPP, solicited public comment on the proposed regulations to replace the "rule of two" with the "sufficient number" formula. Comments due by July 21, 1986.
May 27, 1986	Receipt of invitation from the House Small Business Committee to testify regarding the "rule of two" on Thursday, June 5th.

Mr. Mitchell. Thank you very much. Mr. Coleman.

TESTIMONY OF WILLIAM S. COLEMAN, JR., ACTING ASSOCIATE ADMINISTRATOR FOR PROCUREMENT LAW AND LEGISLATION, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

Mr. Coleman. Thank you, Mr. Chairman.

My name is William S. Coleman, Jr. I am currently the Acting Associate Administrator for Procurement Law and Legislation at OFPP.

In your invitation letter, you asked me to address several topics, which I will summarize very quickly so that you can get to your questions.

You asked that I describe my efforts as part of my official capacity to analyze the significance of CICA in relation to the Rule of Two. My involvement with the question of the Rule of Two included circumstances during July 1985, when we received from Congressman Brooks and Congressman Horton, a request through OMB Director David Stockman for us to try to determine why the three regulatory agencies had not responded substantively to a prior letter.

The prior letter was dated December 12, 1984. The letter described a list that had been prepared by a GAO task group which pointed out deficiencies in the implementation of CICA and the proposed Federal Acquisition Regulation.

Among those listed deficiencies was a statement to the effect that the Rule of Two is inconsistent with the Competition in Contracting Act. I took an assignment to review that complete list, including the statement regarding the Rule of Two, and in my conclusion, I disagreed with the GAO's task group that CICA required repeal of the Rule of Two.

When the agencies subsequently responded to the committee's letter, OFPP concurred and that response did not address the change requested in the Rule of Two. At that point, we were in concurrence with the agencies.

In January 1985, I became aware that general counsel at OMB had issued an opinion that was in concurrence with that GAO task group and we then embarked on a series of discussions with the general counsel of OMB, Mr. Wright, and the various operatives within OFPP.

The outcome of those discussions was such that the opinion of the general counsel of OMB prevailed. We were subordinate as far as that opinion is concerned. We then marched forward to try to make the appropriate changes.

I was asked to include with my statement a copy of a memorandum of a meeting in which the OFPP personnel signed a memo to the record concerning a meeting in March. That memorandum has been submitted and I believe you have a copy of it.

Finally, Mr. Baker deferred to me on the question of Regulatory Flexibility Act assessment. I am responsible for that assessment. The items on page 3 of my testimony, I believe, summarize our view of the Regulatory Flexibility Act impact on our proposed rule.

I will repeat very briefly, it is an internal executive branch rule. It imposes no regulatory burden on small entities in the context of the Regulatory Flexibility Act. We have not made a safety rule that would require additional engineers. We have not asked for additional reports which would require additional accountants, or clerks, or secretaries.

What is going on in this proposed rule is within the executive branch.

The second point is all of the other mechanisms that the agencies have in place to carry out the small business program and the small business set-aside program are still there. They will still have goals. They will still have directors of small and disadvantaged business utilization. They will still have the internal executive branch. All of those things which go to support the small Business Program are still there and are not affected by the proposed rule.

Finally, in our consultations with DOD, GSA, and NASA, we discovered that they were experiencing significant competition under set-aside procurements. I think our last informal review indicates a range of 10 to 12 bid proposals for set-asides.

We did not anticipate, based on our experience, that this situation would change if we changed from the Rule of Two to the sufficient number standard.

Finally, we had numbers from SBA's collection of data that indicated that prior to the adoption of the Rule of Two and subsequent to its adoption the percentages of dollars going to small businesses didn't change significantly. They were relatively stable. So, we did not see that going back to the sufficient number standard would make a dramatic difference.

That concludes my statement. I will be glad to answer any questions you may have.

[See Appendix B for correspondence and exhibits.]

[Mr. Coleman's prepared statement follows:]

PREPARED STATEMENT OF WILLIAM S. COLEMAN, JR., ACTING ASSOCIATE ADMINISTRATOR FOR PROCUREMENT LAW AND LEGISLATION, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

Mr. Chairman and Members of the Subcommittee —

I am pleased to be here this morning to discuss the OFPP draft proposal to modify the Federal Acquisition Regulation regarding small business set-aside determinations which would replace the current "rule of two or more/reasonable price" formula with the "sufficient number/lowest reasonable cost" standard.

I became involved in the question of the validity of the "rule of two" as the result of a letter from Congressmen Jack Brooks and Frank Horton dated July 19, 1985, in which they raised questions about the Federal Acquisition Regulation implementation of the provisions of the Competition in Contracting Act of 1984. The Congressmen were concerned because they had not received a substantive reply to a joint letter of December 12, 1984, signed by Congressmen Brooks and Horton and Senators William S. Cohen and Carl Levin. That letter contained a list of CICA provisions prepared by the General Accounting Office which in their view either had not been or were not properly implemented in the FAR. The GAO list included a statement to the effect that the "rule of two" contained in Part 19 of the FAR was inconsistent with the provisions of CICA which amended Section 16(1) of the OFPP Act. At that time, I made a review of the issues raised in the GAO list and concluded that I disagreed with the GAO view the CICA mandated elimination of the "rule of two."

My next involvement was in January 1985 when I was made aware by William Mathis, Acting Administrator that the OMB General Counsel had issued an opinion which concluded that the "rule of two" was in violation of the provisions of CICA. At that time Mr. Mathis requested that I provide legal opinion on the validity of the "rule of two." After reviewing the issue, I provided an opinion to Mr. Mathis supporting the validity of the "rule of two."

After considerable internal discussions on the issue, the position of the then General Counsel, Mr. Horowitz, prevailed.

In reply to the specific questions raised in the Subcommittee's invitation letter, I do not believe that extraneous considerations have been allowed to influence the outcome of this matter.

Mr. Chairman, you asked for a detailed description of the analysis conducted by OFPP which led to its conclusion that the proposed rule would not have asignificant impact on a substantial number of small business entities under the Regulatory Flexibility Act.

Our determination was based upon a number of factors:

(1) The proposed rule is an Executive Branch procurement regulation which establishes internal procurement procedures and imposes no regulatory burden upon small entities.

(2) If the proposed rule is promulgated, agencies will not be relieved of the responsibility of ensuring that small businesses be provided the maximum opportunity to participate in Federal procurement. All of the operational checks and balances within a buying office will remain in place, notwithstanding revocation of the "rule of two."

(3) On the bases of informal discussions with DoD, GSA, and NASA during 1985 and in seeking to determine the degree of small business participation in set-aside, we were informed that the average number of offers reviewed in a set-aside was 10-12 per action. Indications are that ratio will not change appreciably under the proposed regulation.

The Subcommittee requested that we provide copies of a memorandum signed by William Mathis, Owen Birnbaum and I "relating the contents" of a meeting held between these signatories, Joseph Wright, Michael Horowitz and others. Copies of that memorandum are included among the documents which we have provided to this Subcommittee.

That concludes my statement, Mr. Chairman. I will be pleased to respond to any questions that you or your colleagues may have.

Mr. Mitchell. Thank you, Mr. Coleman.

Mr. Coleman, did you and Mr. Mathis and Mr. Birnbaum sign a memorandum regarding the final decision to be made by your general counsel?

Mr. Coleman. Yes, sir, we did.

[A copy of the referenced memo follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

March 18, 1985

MEMORANDUM FOR THE RECORD

On Monday, March 4, 1985, the undersigned met with Joe Wright, Arlene Triplett, Mike Horowitz, and Diane Weinstein on the Rule of Two. Shortly after the meeting began it was apparent that the topic of conversation (about which we had not been fully informed prior to the meeting) was Mike Horowitz' memorandum to Joe Wright of January 15, 1985 in which he concluded that: "The CICA amendment to Section 16 of the OFPP Act requires that the 'rule of two' in the FAR set-aside regulations be replaced by a 'sufficient number of bids' standard and that the 'reasonable price' standard be changed to CICA's 'lowest reasonable cost' text."

Mr. Horowitz seemed particularly disturbed that OFPP was questioning his legal judgment and was not moving promptly to have the necessary FAR changes made to replace the "at least two" language with the "sufficient number" language he deemed required by CICA. The OFPP representatives then called to Mr. Horowitz' attention the following: 1) The language he relied on in new Section 16(1) of the OFPP Act (inserted by CICA) had to do with the receipt of bid and proposals once an invitation had been issued; 2) CICA itself stated that the sealed bids procedure is to "be used if there is a reasonable expectation of receiving more than one sealed bid" (emphasis added); and 3) both CICA and PL 98-577 specifically recognize small business set-asides as a competitive procedure provided only all eligible small business sources may bid. It was also pointed out to Mr. Horowitz that Congress, in Section 221(j) of PL 95-507, recognized the adequacy for purposes of competition of "at least two" small businesses for a set-aside of small purchases.

After a short while, Joe Wright suggested that we leave the legal question and that OFPP explain to him why, on a policy basis, the rule of two was necessary. Owen Birnbaum explained that the rule had been instituted by DOD in 1979 because its experience had shown that contracting officers were using (or misusing) the imprecise "sufficient number test" to avoid making set-asides. (It was also pointed out that DOD was not particularly known as a friend of small business.) DOD's

experience had shown that the rule was necessary to have an effective set-aside program and that the set- aside program was the "heart" of the small business procurement program. Finally, it was noted that the agencies had annual goals imposed upon them by virtue of Section 221 of PL 95-507 and that the set-aside program was a critical factor in meeting these goals.

Mr. Horowitz seemed to become increasingly irritated with the explanations offered by the OFPP representatives. In the course of his criticisms of the small business and small disadvantaged business programs, he constantly referred to the small business and small disadvantaged business officials as "small business junkies," "OSDBU junkies," and "minority business junkies". It was explained to him that these officials to whom he referred as "junkies" were persons holding positions established by statute (PL 95-507). This made little or no impression upon him, and at one point he appealed to the OFPP staff to "help him get rid of these people" (the OSDBU officials). Mr. Horowitz also made reference to the DOD OSDBU official as "that woman who is giving Will Taft a bad time".

Mike Horowitz complained to Joe Wright about the Federal Government's small business and small disadvantaged business programs and made disparaging remarks about the SADBU officials in government agencies. On at least one occasion, Mr. Horowitz pronounced the acronyms SADBU and OSDBU in a highly derisive manner, which one could interpret as an attempt to effect a black accent.

Toward the end of the meeting, Joe Wright stated that he owed a return call to Mr. Taft who had called earlier to request no final action be taken on the rule of two until DOD had made its case on behalf of the rule. Mention was also made of having this matter go to the Cabinet Council on Management and Administration, but this discussion seemed inconclusive.

The meeting ended with Mike Horowitz' request to Joe Wright that "we political people" (meaning Joe Wright, Mike Horowitz and Arlene Triplett) "meet alone to decide this matter."

William E. Mathis

Owen Birnbaum

William S. Coleman Jr.

Mr. MITCHELL. My problem is not that a particular legal point of view, even if I disagreed with it, was given, if it were based solely on the legal merit of the situation. I have no problem with that.

I do have a problem with the climate and other extraneous motivations which might taint the legal decision, and I quote from your memo:

> Mr. Horowitz, the general counsel, seemed to become increasingly irritated with the explanations offered by OFPP representatives. In the course of his criticism of the small business and small business disadvantaged programs, he constantly referred to the small business and small business disadvantaged business officials as small business junkies, OSDBU junkies, and minority business junkies. It was explained to him that these officials to whom he referred as junkies were persons holding positions established by the statute, Public Law 95-507.

And I am the author of that legislation.

> This made little or no impression upon him and, at one point, he appealed to OFPP staff to help him get rid of these people, get rid of them.

[Pause.]

Mr. MITCHELL. There is a quorum call and to be followed by a 5-minute vote. I want to pursue my line of questioning with you, Mr. Coleman. If the other members want to go and come back, that is fine.

Just to make it in the proper context, a legal opinion based solely on the merits of the situation is acceptable to all of us. A legal opinion tainted by any kind of personal bias, it seems to me, is questionable.

Let me pick up again.

> At one point, he—

And that is Mr. Horowitz, the general counsel—

> appealed to OFPP's staff to help get rid of these people.

That is the office of small and disadvantaged business utilization.

> Mr. Horowitz made reference to the director of the office of small and disadvantaged business utilization in the Department of Defense, that official as "that woman who was giving Will Taft a bad time,"

And I assume he was referring to Ms. Leftwich, one of our witnesses who heads up the office of small and disadvantaged utilization.

> Mr. Mike Horowitz complained to Joe Wright about the Federal Government's small business and small disadvantaged business utilization program, and made disparaging remarks about the SADBU officials in government agencies. On at least one occasion, Mr. Horowitz pronounced the acronym SADBU and OSDBU in a highly derisive manner, which one could interpret as an attempt to effect a black accent.

Is that an accurate quote?

Mr. COLEMAN. That is an accurate quote from the memo, sir.

Mr. MITCHELL. Then, it seems to me that the whole question of the legal opinion offered by your counsel comes into question. If it were done within the context of making disparaging remarks and effecting an accent to denigrate black Americans, then one would have to question the validity of that decision.

Would you, Mr. Wright.

Mr. WRIGHT. Mr. Chairman, I have the memo in front of me, and I was reading along with you. That is what the memo says, but I cannot let it sit there. I also attended that meeting, and, I really cannot, in good faith, even though Mr. Horowitz is not here, allow him to be denigrated by a memo which clearly infers to somebody's interpretation of what they thought was meant.

Mr. **Mitchell**. Are you not denigrating Mr. Coleman and Mr. Mathis and Birnbaum, the signers of that memo?

Mr. **Wright**. I would suggest, Mr. Chairman, and Mr. Coleman knows he can speak if he wants to——

Mr. **Coleman**. Sure. I will.

Mr. **Wright** [continuing]. On this issue, whether or not he took the interpretation of Mr. Horowitz's frustration as one which was denigrating to black people in this way.

I would say, from my standpoint, we are talking about an individual here, as I mentioned to you before, who was one of the freedom riders during the very early civil rights movement when it was not popular to do so and that was a very, very——

Mr. **Mitchell**. I recall that conversation, and if you will recall my answer to that, my response to that, I think I couched it very succinctly and clearly.

Mr. **Wright**. I think you did.

Mr. **Mitchell**. I said that I enjoy a cold glass of milk. It is a healthy drink, but milk can curdle and become sour and no matter what happened in the past, the possibility of a curdling, a souring can take place.

Mr. **Wright**. Mr. Chairman, I had known Mr. Horowitz for several years, while he was the general counsel at the Office of Management and Budget, and I had not one time ever heard him make a racially disparaging remark and, as I mentioned to you at the time, which is equally important, if that would have occurred within my office, the conversation would have stopped right there and we would have had a disciplining session.

Mr. **Mitchell**. Let us forget the racial connotation.

Would you not assume that a man who talks about officials in government placed there to help small business and small disadvantaged businesses, if he refers to them as junkies consistently, would that not strike a chord with you in terms of his capability or the soundness of his legal opinion?

Mr. **Wright**. There was more than just this one meeting. What you have is one memo. This deliberation went on for 2 years.

Mr. **Mitchell**. One memo is sufficient for me.

Mr. **Wright**. Yes; Mr. Chairman, it is. Two years are sufficient for me.

Mr. **Mitchell**. We will take a break, and we will resume this line of questioning when I return.

[Recess.]

Mr. **Mitchell**. The hearing will now resume.

I know the hour is late, and we will try to move as rapidly as we can.

I just have one other question that I want to put to Mr. Baker.

On page 4 of your statement, you also admit that OFPP did not consult with SBA on the Rule of Two. For your edification, let me give you three provisions of the OFPP Act.

The first provision: 41 U.S.C. section 45(e) requires that the OFPP administrator consult with the affected agencies including the Small Business Administration in carrying out the functions and duties of his office.

You said that you did not consult.

Mr. Baker. May I clarify my comment?

Mr. Mitchell. Sure.

Mr. Baker. What I said and what I intended to say was that we could not find evidence in our files of formal consultation having taken place 2 years ago, prior to the issuance of the October 1984 notice.

I personally was not involved in the process then. I do not know if consultation did, in fact, take place. Oftentimes, we do have ongoing informal discussions. I assume that may very well have happened then, though we have no documentary evidence of it.

Mr. Mitchell. You cannot document it.

The second specific provision of the act, 41 U.S.C. section 45(a), requires that OFPP in formulating the FAR shall, in consultation with the Small Business Administration, conduct analyses of the impact on small business concerns resulting from revised procurement regulations.

You did not do any joint analysis or consultation, is that correct?

Mr. Baker. No, Mr. Chairman; I do not believe it is. In going through the files over the past 2 years, dealing with this specific issue, for example, we found at least 10 pieces of correspondence on the Rule of Two between us and SBA. Several of those letters were from us, several from SBA.

Mr. Mitchell. Did those letters relate to analysis of the impact on small business concerns?

Mr. Baker. I do not recall specifically, but I assume they must have, because the impact is fundamental to the discussion.

Mr. Mitchell. The third provision of the act provides that it is the policy of the Congress to promote the effectiveness of the acquisition system by promoting the participation of small business concerns.

Every witness this morning has indicated that the proposed regulations would have the precise opposite effect. Why do you think the Congress put all these safeguards into the act?

Mr. Baker. Mr. Chairman, I am not at all convinced that the effect of repealing the Rule of Two will be as it has been described by others. I am not convinced, for example, that it is going to significantly harm the small business set-aside program or result in a significant or even measurable reduction in small business set-asides.

Mr. Mitchell. All right.

Mr. Wright. By the way, Mr. Chairman, if I may.

Mr. Mitchell. If I may, let me just finish something here.

We in the Congress move very slowly on occasion and we build in safeguards, and I do not think it is unreasonable to expect that the agencies would adhere to the law.

This is a law, and it would seem to me in your position, whomever preceded you, that recognizing that this is the law of the land, those provisions should have been carried out to the letter.

Mr. Baker. Mr. Chairman——

Mr. Mitchell. One of the problems, and I am old enough and take a kind of philosophical view about government, I am old enough to realize that when any agency of government evades, flaunts, perverts, or distorts the law of the land, you begin the process of eroding that which has held our country together.

I am going to ask Mr. Torres to lead off with the questioning, please.

Mr. **Wright**. Mr. Chairman, may I respond to that very briefly?

The problem that we have here is that we are before a chairman of one committee who is saying that this is the law of the land, and there is a chairman of another committee within the House of Representatives who is saying there is a different law of the land.

Mr. **Mitchell**. No.

Mr. **Wright**. And, so, therefore, that is a problem——

Mr. **Mitchell**. Do you mean to tell me that the chairman of that committee said that you were not to carry out those provisions? I find that incredible.

Mr. **Wright**. No, sir.

Mr. **Mitchell**. Well, I am focusing on just that portion of the act. That is all I was talking about.

Mr. **Wright**. OK. I am sorry.

Mr. **Mitchell**. And it defies credulity to assume that any chairman of any committee would dare say that you could violate the law, and I am talking only about that.

Mr. Torres.

Mr. **Torres**. Thank you, Mr. Chairman.

As I said in my opening statement, I thought this hearing was probably unnecessary. I now believe that it is more necessary than ever. As I said earlier, legislation has been introduced that would make the Rule of Two statutory. Perhaps we would not need these kinds of discussions if it were.

I would like to direct my questions to Mr. Coleman and his testimony.

You said that on two separate occasions, you found the Rule of Two to be consistent with CICA, am I correct?

Mr. **Coleman**. That is correct, sir.

Mr. **Torres**. The first occasion involved your review of the issues raised in the GAO list?

Mr. **Coleman**. That is correct, sir.

Mr. **Torres**. And the second occasion was when Mr. Mathis, William Mathis, requested that you provide a legal opinion on the validity of the Rule of Two. Am I correct?

Mr. **Coleman**. That is correct, sir.

Mr. **Torres**. In the end, however, as your statement so indicates, the position of Mr. Horowitz prevailed.

Mr. **Coleman**. Yes, sir.

Mr. **Torres**. I am anxious to know, as I am sure the rest of the committee is, why did Mr. Horowitz's position prevail? I mean, given what I thought was an adequate legal opinion by you, sir.

Mr. **Coleman**. You have to understand, sir, that the organizational structure of OFPP within OMB is that the administrator of OFPP reports to the director of OMB.

On any matter that requires the concurrence of the director of OMB, the subject passes through the office of general counsel for clearance. In this case, there were differing opinions from OFPP and from the office of counsel of OMB.

There were a number of meetings to discuss the pros and cons and the legality, and the language of CICA, and the legislative history of CICA, and the reports. In the final analysis, as the statement says, Mr. Horowitz, who was the chief lawyer in the OMB complex, was able to prevail in his opinion.

Mr. TORRES. And he alone carried this out without consultation with his peers?

Mr. COLEMAN. He had his own staff. I worked for the administrator of OFPP. He had the staff or, at that time, had a staff of lawyers who also, I am sure, provided analysis to him in support of his opinion.

Mr. TORRES. I am highly incensed with the memorandum we have before us, and at Mr. Horowitz's disparaging remarks and attitudes. I take great issue with, Mr. Horowitz's attitudes and behavior.

Would it be fair to say that this kind of attitude and comportment outweighs legal opinions and he himself is of this notion?

Mr. COLEMAN. I was asked in the invitation letter to give my opinion on whether or not extraneous matters influenced the decision, and I stated in my written testimony that I did not so believe.

As Mr. Wright started to say in his response to another question, this meeting was a culmination of a series of meetings in which, to be very honest with you, OFPP was taking an opposite view of the issue, and Mr. Horowitz became more and more concerned that as the chief lawyer, he was being ignored.

The portrayal in this memo is, as I said earlier, accurate. He went off, to be honest with you. As I have said to others who have asked me about it, I was intellectually insulted. I was not particularly insulted as a black person because I was considering the atmosphere and the situation as it arose.

Certainly, the memo is an accurate portrayal. I do not know that other influences caused the determination that Mr. Horowitz came up with. I honestly do not know. There were other lawyers engaged who also argued that CICA required repeal of the Rule of Two in that same meeting.

Mr. TORRES. Thank you, Mr. Coleman.

Mr. Wright, you were there also, and you would not concur with Mr. Coleman's assessment?

Mr. WRIGHT. I do not believe that the comments that were made, while they were active and it was a strong disagreement, within not only the executive branch but within OMB itself.

I did not hear anything that could be construed as racial, a black accent, or anything like that at all, and as I mentioned to the chairman, if it would have, we would have stopped the meeting right there and we would have had a little career discussion with Mr. Horowitz.

Now, that simply was not my understanding, my interpretation, or my feeling at the time. But, as Mr. Coleman said, you had the general counsel of the Office of Management and Budget, who had made his position known clearly over and over again, basically felt that we were not carrying out the law as had been mandated by the Congress. And he was quite upset with just about everybody in that room.

Mr. **Torres**. Mr. Chairman, will we have an opportunity at any point to hear from Mr. Horowitz?

Mr. **Mitchell**. If the members of the committee agree that we should, I would be delighted to have him come in.

Mr. **Torres**. I think it would be appropriate, sir, to have Mr. Horowitz come before us and, in all fairness to him, give his side of the story.

Mr. Chairman, I yield back the balance of my time.

Mr. **Mitchell**. Congressman Gallo.

Mr. **Gallo**. Thank you, Mr. Chairman.

One of the things that I find a little difficult to understand is the letter that upon request from, I believe, you, Mr. Wright, or members of your staff, sending out letters to the two committees that had oversight on this. Your request as to their interpretation of the CICA law relating to the Rule of Two.

In the one letter, which, I think—I do not know whether it was Mr. Coleman or Mr. Baker who responded to this, but maybe it was you, that said it is clearly inconsistent with the spirit of that law.

Now, I know I come from State legislature, and we have an oversight or had an oversight committee because, many times, laws that are promulgated or passed by the legislature somewhere along the line we put at the bottom, rule is to be promulgated by the proper authority, and sometimes those rules and regulations do not represent the true intent of the law as to the sponsor or the person initiating it.

And it is surprising to me that the response at this time from Mr. Brooks and Mr. Horton indicated that there was an inconsistency.

There was also a letter of inquiry that was sent to the Senate, I believe, Governmental Affairs. I do not seem to have a response or a copy of that response.

Was there a response?

Mr. **Wright**. I do not believe we sent a letter to the Governmental Affairs Committee, Mr. Gallo, asking for their opinion.

I believe the letter was sent to the Government Operations Committee. The first letter that we received with the interpretation of both Government Operations in the House and Governmental Affairs in the Senate, was dated December 12, 1984. It was addressed to the three agencies, DOD, NASA, and GSA, and we received copies. The letter was from Senators Cohen and Levin, who were cosponsors of CICA, and also Brooks and Horton in the House, who were the cosponsors.

Mr. **Gallo**. Was the response from the Senate, the Senators, similar to that of——

Mr. **Wright**. Yes; as a matter of fact, all four of them signed the same letter.

Mr. **Gallo**. Well, they did not. I have got the one letter.

Mr. **Wright**. It was 1984, Mr. Gallo.

Mr. **Gallo**. Oh. I am sorry. OK.

I do not know whether we have a copy, Mr. Chairman. I would like to have a copy of that letter, if I may.

Mr. **Wright**. Sure. We sent it on up with the package.

But I thought it also very interesting that, in that letter, they were very, very clear about coming up with the responses from a

General Accounting Office task force, which said that "Part 19," space "retains the Rule of Two, which we believe is no longer appropriate under CICA."

Now, whether we agree with that or not, that was December 12, 1984. They basically asked for the three contracting agencies to take action.

Mr. Gallo. Well, it would send a clear message to me, if I were in your position, that the intent by Congress or certainly the committee which this law originated from, was very clear that there was a conflict. It surprises me, based on some of the statistical information which shows that when the Rule of Two was initiated, there were tremendous increases in the percentage of set-aside, starting with 33.6 percent and in 1985, 53.8 percent.

It certainly would fly in the face that the Rule of Two was working, and I think that there has been some confusion based on those letters from the committees dealing with it. I am not quite sure why they would find that conflict and as originators of the legislation and then everyone else finding no conflict.

So, it certainly would lead you to a determination to evaluate that and maybe that had some reason for your final opinion. I do not know.

Mr. Wright. Mr. Gallo, there was a disagreement within the Congress on the Rule of Two, within the administration, and within the Office of Management and Budget, which is one of the reasons for the very long period of time in implementing the law. The interpretations from the cosponsors in both the House and the Senate on exactly what was meant regarding the Rule of Two in the Competition in Contracting Act came to us on December 12, 1984.

Since there was this disagreement, we bent over backward to make sure. We specifically went to Government Operations, in this case, and asked exactly what was their intent.

As a matter of fact, we went further than that, and said that if it is true that we are in violation of the law, then I want somebody from the Congress to say exactly what the intent was and I want it in writing. That is why you have a long chronology here in terms of the correspondence going back and forth between us and the Congress.

I think you are probably correct regarding the impact of the Rule of Two that the percentage of the small business awards went up, but I do not believe the dollars did much one way or the other. I do not think they particularly changed, and I believe the GSA testified that they did not see any great impact from the time when Rule of Two was expanded into the civilian agencies. So, there is a real disagreement here as to how important the Rule of Two is.

Mr. Gallo. Let me just interrupt you.

At that stage, at least the figures I have, the figures did go up significantly from $4.8 billion to $14 billion. That is a significant increase, as far as I am concerned.

Mr. Wright. We have some incomplete data, Mr. Gallo, from 1973 through 1985 which depicts the percent of dollars awarded to small business, and that percentage stayed essentially the same throughout that entire period, from about 20.5 percent in 1973 to

19.1 in 1984. It shows, in fact, a bit of a decline in that period, even though when the period began, the sufficient number formula was being used, and was subsequently changed to the Rule of Two.

So, the data are not clear as far as we are concerned.

Mr. GALLO. Can I ask you, Mr. Wright, a question on the CICA, which was passed in 1984?

Does OMB usually take this long in issuing a proposed rule change, or was it because of the circumstances surrounding it?

Mr. WRIGHT. Mr. Gallo, I promise you, we do not normally take this long in issuing a rule change. I think one of the things that has come up during the hearing on this issue is all of the disagreements that exist, not only as to what is the right thing to do, but what is the correct interpretation of the legislation. This is why I wanted to make it very clear to the chairman, who came in and asked why the precipitous action. As a matter of fact, I cannot recall one case where we have ever taken this long. I am sure there are, but I cannot recall it.

Mr. MITCHELL. Will the gentleman yield?

Mr. GALLO. Yes.

Mr. MITCHELL. I will check with the written testimony. It is my recollection that I did not say precipitous. I referred to the capriciousness and arbitrariness of it.

Thank you for yielding.

Mr. GALLO. Mr. Coleman, there was mention about this particular letter. It is dated March 18, 1985.

Can you tell me when that meeting took place?

Mr. COLEMAN. I believe it was March 4, when the actual meeting took place.

Mr. GALLO. March 4. So, I assume the memo was written some time between March 4 and March 18, is that correct?

Mr. COLEMAN. That is correct. After discussions between Mr. Mathis, Mr. Birnbaum, and myself, Mr. Birnbaum set out to write a record of the meeting, and we all signed it on the date indicated.

Mr. GALLO. Can you tell me why a letter of this magnitude would not be brought to the attention of one of the committees?

Mr. MITCHELL. That was not a derogatory remark. That was not a response to you.

Mr. COLEMAN. I am sorry. Your question was why was it not brought to the attention of the committee?

Mr. GALLO. I would think that three individuals writing and at least signing on the letter would bring it to someone's attention.

Mr. COLEMAN. We, frankly, were engaged in what we thought was a legitimate debate on whether or not the Rule of Two should be changed, and what we were simply doing was documenting the meeting for internal purposes.

We wanted our position clearly stated in writing and it happened that all the other acrimony that went on was part of that meeting.

So, it was part of our own internal record, which is why we did not come to the committee with it, sir.

Mr. GALLO. Mr. Wright, would you, from your review of this and it has been intensive, still feel very strongly that this regulation is required based on CICA?

Mr. WRIGHT. Mr. Gallo, first of all, I am not a lawyer, and do not pretend to be one. One of the reasons, again, we went for confirmation back to the committees, even though it was 1½ years after we had first received the correspondence, was that this was their interpretation and that this is exactly what they wanted to be done in terms of the Rule of Two and its relation to CICA.

At this stage I feel very comfortable that this was the intent of the writers of that legislation. I think that this is one of the problems that we have in many cases, and I say this with all due respect, that when we have legislation that is not very clear, it is very, very tough to interpret. This is the kind of process that we will go through, however, which can take years.

Therefore, at this stage, I believe that we are following the Competition in Contracting Act in good faith. If the Congress feels that this is not appropriate, I think it is up to the Congress to draft the language under which they want the Competition in Contracting Act to operate.

Mr. GALLO. Well, I think that is obviously always our alternative. I am wondering from the array of witnesses that have come before this committee, all—well, almost—unanimous in their opinion, that there is not a conflict.

I do not want to superimpose any decision that you are going to make down the line, but I would think that that would have a significant impact on your overall decision as to whether that rule will apply.

Mr. WRIGHT. We know that there is an internal conflict within the administration. This was the reason we went back for confirmation again at the end of last year and the beginning of this year. Not only confirmation, but direction from Government Operations.

I would also say that there are many pieces of legislation that the executive branch implements that it does not necessarily agree with, but it is the law of the land.

Mr. GALLO. I would say that it becomes increasingly clear that the legislative remedy is what we should pursue, and I would suggest to the chairman if we are going to have any other hearings on this, that at the next meeting with Mr. Heatherly that we may want to hear from representatives of the specific industries that have voiced their objection.

Mr. MITCHELL. Yes; I concur. Thank you. Thank you very much.

Mr. GALLO. Thank you.

Mr. MITCHELL. Would you indulge me for just one moment, Congressman Ireland? There are two things that have come up.

One, with reference to the opposition. Those are all architectural and engineering firms. The particular category of people who had a vested interest in opposing it.

Second, with reference to the intent of the law, you said in order to find the intent of the law, you consulted the principal committee sponsors and so forth.

As a matter of fact, Public Law 98-577 amended CICA in several places with specific reference to small business set-asides, and whether set-asides should be considered full and open competition.

You, out of your ignorance perhaps, did not know that the substitute amendment adopted verbatim by the House and the Senate, which became Public Law 98-577, was my amendment. My amendment. Perhaps, out of ignorance, you did not know that, but certainly someone should have researched it and, therefore, there should have been some consultation with me.

During all this time period, there was no consultation. I am the author of the substitute amendment that was adopted by the House and Senate.

Congressman Ireland.

Mr. **Ireland**. Having been the author of the Regulatory Flexibility Act, I am also very interested in it.

Mr. Baker, I jotted down a couple of things that you said along the way.

In regard to the proposal in Mr. Coleman's testimony and your backup of it, Mr. Baker, you said that it would not affect all small businesses doing business with the Government. While you said that you have some data, but it was incomplete, you were convinced that no analysis was necessary.

Well, we passed what is a good law. We do not rely on individual personal recollections of things or people who say that they have data that is incomplete to make analyses.

On the one hand, you are saying it is not necessary; on the other hand, you are giving us your personal analysis. Well, in all due respect to you, I can not let you say that because you are the executive branch the law does not affect your procedures.

I believe your proposal will have an effect on the number of small businesses that do business with the Government. Now, if you come back to me and say, the statistics we have say it will not, well, you are doing an analysis, even if it is incomplete. So, I would suggest you cannot have it both ways.

Mr. **Baker**. Mr. Ireland, what I was doing was responding to a question as to the effect this might have on the small business community.

Mr. **Ireland**. That is what the Regulatory Flexibility Act asks. Does it have an effect? You say it has no effect, but you are giving an opinion, because you have not done an analysis.

Mr. **Coleman**. Mr. Ireland, I am the culprit on the certification.

Mr. **Ireland**. Well, there is no culprit.

Mr. **Coleman**. Well, I am the author. I will put it that way. I am the person who wrote the analysis or the statement that in the public notice that indicates that there will not be a significant economic impact on small entities.

Mr. **Ireland**. Excuse me. Right there, let us stop there a minute.

Mr. **Coleman**. OK.

Mr. **Ireland**. You had made a judgment there.

Mr. **Coleman**. Based upon information that was available to us.

Mr. **Ireland**. Based on information, but the Regulatory Flexibility Act says do not take just general information—do an analysis.

Mr. **Coleman**. It also——

Mr. **Ireland**. And about how that analysis should be done, and you have not done it that way.

Mr. **Coleman**. Sir, may I? It also says that if the head of the agency can certify that the proposed rule does not have a significant economic impact, then that certification can be published in the public notice with a copy sent to the chief counsel of that——

Mr. **Ireland**. You are not certifying—OMB is not certifying that it does not have an effect.

Mr. **Coleman**. Yes, sir.

Mr. **Ireland**. You are not certifying anywhere in here. There is no certification in here. So, it is just your general testimony and opinion here that you have done what is required and that is certify that getting rid of the Rule of Two will not have an effect.

Mr. **Coleman**. And we will certainly endeavor——

Mr. **Ireland**. You do not know one way or the other.

Mr. **Coleman**. We will endeavor to comply with the act, sir.

Mr. **Ireland**. Pardon?

Mr. **Coleman**. We will definitely endeavor to comply with the act. We certainly will.

Mr. **Ireland**. But you have not—it calls for you to certify it does not have an effect, and you have just said that it does, and, yet, you have not certified that. I am not even saying it could—I personally feel that it will.

Mr. Baker says it will not. Neither of us can put any analysis down that it could have an effect. Now, it would seem to me if you do not think it is going to, you have an obligation under the law to certify it.

Mr. **Coleman**. That is what we intended to do, sir. If we have not done that, then we will go back, look at the question again, and take proper action under the Regulatory Flexibility Act.

Mr. **Ireland**. Yes; I like that. You are going to take the proper action.

Let me ask you this: In the same regard, touching on these two things, the CICA and the Regulatory Flexibility Act, we obviously are talking about an opinion, however it arrived in the bowels of the OMB. You came forward with an opinion that you are going by here on Regulatory Flexibility and on the CICA.

Now the gentleman, Mr. Horowitz, I guess, was the final one making that decision with the stamp of the Director.

Is there a written analysis that gave the reasons for this final decision? Where is that written analysis and do we have a copy of it?

Mr. **Baker**. Yes, sir; you do. It was provided to the subcommittee this morning. I believe it is dated January 1985, but I do not have the specific date.

Mr. **Ireland**. OK. So, we have that in hand?

Mr. **Baker**. Yes, sir.

Mr. **Ireland**. OK. And on the analysis of Regulatory Flexibility?

Mr. **Baker**. This is the analysis of CICA and the impact it would have on the——

Mr. **Ireland**. It was adopted. The train of thought and everything else. That is in our record.

Mr. **Baker**. That is the formal written opinion from the chief counsel.

Mr. **Ireland**. Now, let me ask this: I am pretty sure this was the GAO's testimony. They testified in setting the record straight as they saw it, that this proposal was made under the wrong section of the act.

Mr. **Baker**. We do not believe that is true at all. We think section 6 of the act specifically gives to OFPP the authority to issue regulations when OFPP finds that the procurement regulatory agencies have not done so in a timely fashion. That is the phrase from the statute.

We considered that inasmuch as we had given direction to the regulatory agencies several months ago, and we had been told, in effect, that they were not going to comply with that direction, then this particular provision of the law came into operation. It was on that basis that we issued the proposed rule.

Mr. **Ireland**. I can not be a judge, but it sounds to me like the view of the gentleman from GAO was pretty clear that this was promulgated under the wrong section of the act.

Mr. **Baker**. Mr. Ireland, if I may, I would also point out that, as I recall, the persons testifying from the three procurement regulatory agencies this morning also supported the fact that we had acted properly in terms of citing the proper authority.

Mr. **Ireland**. Mr. Coleman, I look forward, from wherever this comes from, to this certification that you are, indeed, going to provide.

Mr. **Coleman**. The notice. Yes, sir.

Mr. **Ireland**. I think that is a key item because it certainly, in my view, could be very critically challenged, and I appreciate that, and I thank you, Mr. Chairman.

Mr. **Mitchell**. Thank you.

Congressman Gallo has one additional question.

Mr. **Gallo**. Just one followup question, so I can clear the record which may be a little confused.

I gave you some statistics. Those statistics were the sources, the report from the departments and agencies and the Federal procurement data system, which are markedly different from what you have indicated.

I would like to know what you were quoting from.

Mr. **Baker**. As a matter of fact, it is from the same Federal procurement data system. It is dated March 25, 1986.

Mr. **Gallo**. Do they have two sets of books or what?

And this is March 27. So, I assume my figures are more accurate.

But I just want to make it clear so that the testimony does not look confused, we are both using the same statistical sources with the date 3 days later there had been a marked increase in the amount of—even looking at, even looking at your—the 25th, March 25, record, there is, starting in 1979, an increase from 4.1 percent to 14 percent by 1985. I think that is a significant increase.

So, there really—you indicated that it did not look that great through 1973, but unless I am having difficulty reading the figures, they look pretty accurate to me, that there has been a significant increase from 1979 through 1985, dealing with Rule of Two.

Mr. **Baker**. I think the point I was trying to make, Mr. Gallo, was that there has been a fairly steady allocation in terms of percent of dollars to small business during this timeframe. The line that I have underlined on the data sheet which you have is the one I was looking at. It indicates in 1973, 20 or 21 percent of the dollars had been provided to small business, and in 1985, 18.7 percent.

That was the only point I was trying to make.

Mr. **Gallo**. OK. Fine.

Then, we do not have a great disparity with the two reports.

Thank you very much for clearing that up.

Mr. Mitchell. It is now time to sort of sum up.

I do have additional questions. I recognize that the hour is late, and I would like to submit those questions to you gentlemen for a timely response.

For the members of the committee, we must get together very informally, very quickly, to at least discuss the possibility of legislation to prevent the destruction of the Rule of Two. Also, for the members of the committee, after we consult, if you so desire, we will have Mr. Horowitz here. In fact, we can have him and Mr. Heatherly here on the same day. I will consult with you on that.

Finally, let me say that it is impossible, it is impossible for me to disabuse my mind of the fact that a legal decision was made in the kind of atmosphere described in that memo. It is impossible for me to disabuse my mind of the fact that respected agencies of Government disagreed with your position.

It is impossible for me to disabuse my mind of the fact that extraneous considerations entered into the final decision. I would hope, Mr. Wright, Mr. Baker, Mr. Coleman, that in light of these hearings this morning, and what is a reasonable interpretation that I have just given to you, that you would halt any further proceedings on the Rule of Two until such time as you gentlemen, who I think want to be good public servants, look at these extraneous factors, look again at the opinions of the agencies.

That is all I can do to ask you. That is all I can do, but I think in fairness to the Congress, all the members, in fairness to the small business community, in fairness to your comrade agencies, that is the least you can do.

Thank you very much for being here this morning.

Mr. Wright. Thank you, Mr. Chairman.

[Whereupon, at 1:30 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

OMB EFFORTS TO REPEAL THE RULE OF TWO

WEDNESDAY, JUNE 18, 1986

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON SBA AND SBIC AUTHORITY, MINORITY ENTERPRISE AND GENERAL SMALL BUSINESS PROBLEMS, COMMITTEE ON SMALL BUSINESS,

Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2359-A, Rayburn House Office Building, Hon. Parren J. Mitchell, (chairman of the subcommittee) presiding.

Mr. MITCHELL. Good morning. The hearing will now come to order.

On Thursday, June 5, we started our hearings to determine the circumstances surrounding OMB's effort to repeal the Rule of Two test for competition for small business set-asides.

During the course of the hearing, we heard from a number of agencies: The Department of Defense; the National Aeronautics and Space Administration; General Services Administration; General Accounting Office, and two former OFPP Administrators, all of whom are unanimous in their decision that the Competition in Contracting Act does not require the repeal of the Rule of Two.

We think that OMB has uniquely interpreted the Competition in Contracting Act and at our last hearing, we focused in on the legality of the OMB action.

I'm going to ask unanimous consent that my entire opening statement as well as Congressman Torres' opening statement, be submitted for the record. We have a problem this morning in that the House is going in at 10 a.m. and we will have the usual rollcall votes and so forth.

Unfortunately, we'll have to suspend the hearing when recorded votes are ordered to go over and make our vote.

OPENING STATEMENT OF CHAIRMAN MITCHELL

On Thursday, June 5, we began our hearings to determine the circumstances surrounding OMB's effort to repeal the Rule of Two test of competition for small business set-asides. We were told by the deputy director of OMB that there was a split among the various agencies over this controversial issue that had been and continues to percolate throughout the Government.

The evidence disclosed that the Deputy Director was absolutely correct. On one side of this split we have the Department of Defense, the National Aeronautics and Space Administration, the General Services Administration, the Small Business Administration, the General Accounting Office, two former OFPP Administrators and its present Associate Administrator for procurement law and legislation—unanimous in their opinion that the Competition in Contracting Act [CICA] does not require repeal of the Rule of Two. On the other side of this split, we have the opinion of Michael Horowitz, former OMB general counsel. It is his legal opinion that continues to drive the present OMB effort to repeal the rule.

In addition to OMB's uniquely peculiar interpretation of CICA, our last hearing also focused on the legality of the OMB action. Based upon the testimony received during that hearing, and review of the internal memoranda provided us by OMB, it appears that OMB may have violated the Regulatory Flexibility Act; those provisions of the OFPP Act requiring consultation with the SBA; those provisions of the OFPP Act pertaining to dispute resolution among the three regulatory agencies; and OFPP letter 85-1 that purports to implement section 6 of the OFPP Act.

It is quite apparent to me that the evidence paints a rather graphic picture of a system that has, simply, broken down. Statutory provisions were either convoluted, violated, or just ignored. The legal and policy opinions of the entire Federal acquisition community were summarily rejected. Some Members of Congress were consulted while others were apparently avoided. The legitimate interests of small business became an expendable commodity in OMB's singular, driving desire to repeal the Rule of Two.

But, what were the motivational forces which propelled OMB to stray from the law despite the combined urgings of the entire Federal procurement community? The record, thus far, does provide us with some answers.

It is clear that size standards and SBA's system for determining size lies at the center of this controversy. Its desire to keep set-aside numbers artifically high, coupled with its refusal to base the standards on Federal market share and its unwillingness to impose subcontract limitations under a set-aside contract, are all indicative of the fact that SBA had lost sight of the very purpose of the set-aside program. It is SBA's failure to act that has brought us to the point where we may now lose the entire set-aside program.

Anyone familiar with this issue will readily admit that organizations of A&E firms and their supporters in the congress have led the charge to repeal the Rule of Two. I have experienced the same frustration as the A&E community in trying to work with SBA. I fully agree with the premise that we simply cannot have a preference program if everyone is a preference eligible. However, our request for the production of internal OMB documents has produced more than one memorandum about private meetings with A&E representatives and OMB officials. At one of those meetings, which took place in early April 1985, a high ranking official of the most vocal A&E association opposed to the rule readily admitted, "but not for public dissemination", that the Rule of Two was not his problem but that his organization had used it, "to get the Government's attention." This association admitted that the real problem was SBA's unreasonably high size standard and SBA's refusal to bring its size standard into line with the realities of the marketplace. While I cannot fault this association's frustration, I do, however, question its tactics.

Added to this evidence that the Rule of Two was used as a ruse to get the Government to lower an admittedly high size standard, are other internal memoranda indicating that the OMB's office of general counsel had an obvious disdain for Federal employees charged with the primary responsibility to implement small and minority business programs. Aside from the meeting that took place in the Deputy Director's office on March 4, 1985, which was the subject of much discussion at our last hearing, we have found another memo indicating that others in OMB's office of general counsel were intent upon restraining the activities of Federal small business advocates. In this memo to the Deputy Director, dated September 19, 1985, the office of general counsel urges that the newly created competition advocates implement the proposed sufficient number/lowest reasonable cost test for set-asides. Counsel recommends that OMB, "*Pit* the competition advocates against the small business reps.", (emphasis supplied) in an obvious attempt to slow the program.

In short, the record of OMB's actions are so tainted with questionable motivations and blatant violations of law that its notice to repeal the Rule of Two ought to be immediately rescinded.

Today we have with us witnesses from the private sector and the Acting Administrator of SBA, Charles Heatherly. We note that this is his first appearance before this committee and welcome his participation at these proceedings.

We hope to obtain today a clear explanation of SBA's role in this entire episode and to find out whether it agrees with the testimony we heard 2 weeks ago from major small business organizations regarding the effect of repealing the Rule of Two.

Opening Statement of Hon. Esteban Edward Torres, a Representative in Congress From the State of California

Chairman Mitchell, I want to thank you for having this hearing. As you know, I consider the OMB proposal to repeal the Rule of Two Set-aside Program to be one of the most important issues facing Congress today.

I also want to welcome Acting Administrator Heatherly to Capitol Hill. Your appearance has been eagerly anticipated by many of us on the Small Business Committee.

Two weeks ago, this committee heard testimony from a number of expert witnesses about the proposed repeal of the Rule of Two. Representatives of the small business community told us how well the Rule of Two worked for small businesses, and how badly small business would be hurt by its repeal.

Representatives from the DOD, NASA, and GSA told us how pleased they were with the Rule of Two, and how dificult it would be to ensure small business participation in the Federal procurement process without it. All of these witnesses, including representatives from the GAO and SBA, told us that the Rule of Two increased competition, and that it conformed with the Competition in Contracting Act.

Yet, despite the compelling evidence that has been presented against the repeal of this crucial small business set-aside program, OMB continues to force an arbitrary and ill-conceived proposal on Federal purchasing agencies. Quite frankly, I fail to see either the need or the basis for such a policy.

If, as OMB has stated, these regulations are an attempt to reflect the will of Congress, then OMB has failed. The record is clear: The Rule of Two helps small businesses. The Rule of Two increases competition. And more importantly, the Rule of Two reflects the will of Congress.

Mr. **Mitchell**. I am delighted that Congressman Ireland is with us this morning. Do you have an opening statement, Congressman Ireland?

Mr. **Ireland**. No opening statement, Mr. Chairman. Thank you for allowing me to sit in on your subcommittee. I really appreciate the way you've conducted these hearings and for giving everybody a chance to have their view. And I appreciate the fact that Mr. Heatherly has taken time to come and give us the view of the Small Business Administration.

Thank you.

Mr. **Mitchell**. Thank you. I, too, appreciate your taking the time to be with us. Our leadoff witness is Mr. Charles Heatherly, who is the Acting Administrator of the Small Business Administration.

I would just remind to you that we have a copy of your statement. If you so desire, you can simply give the highlights, and then we'll ask some questions.

TESTIMONY OF CHARLES L. HEATHERLY, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

Mr. **Heatherly**. Thank you, Mr. Chairman. I ask that my full statement be put into the record.

Mr. **Mitchell**. Without objection, it will be so ordered.

Mr. **Heatherly**. The only thing I will say in opening is that our position on the Rule of Two is very clear from our statement and from our previous communications. We fully support the retention of the Rule of Two and are not in agreement with OMB's intepretation of the CICA. We would hope that OMB would reconsider its actions, and either rescind or modify its proposed regulations.

[Mr. Heatherly's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF CHARLES L. HEATHERLY, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM CHARLES L. HEATHERLY, ACTING ADMINISTRATOR OF THE SMALL BUSINESS ADMINISTRATION. I APPRECIATE THE OPPORTUNITY TO TESTIFY ON BEHALF OF THE SMALL BUSINESS ADMINISTRATION REGARDING THE STANDARDS FOR INSTITUTING SMALL BUSINESS SET-ASIDES IN FEDERAL PROCUREMENT.

ON MAY 22, 1986, THE OFFICE OF FEDERAL PROCUREMENT POLICY PUBLISHED IN THE FEDERAL REGISTER A PROPOSAL TO MAKE A SIGNIFICANT CHANGE TO THE EXISTING STANDARDS FOR INSTITUTING SET-ASIDES. AT PRESENT, PROCUREMENTS ARE SET-ASIDE "IF THE CONTRACTING OFFICER DETERMINES THAT THERE IS A REASONABLE EXPECTATION THAT (A) OFFERS WILL BE OBTAINED FROM AT LEAST TWO RESPONSIBLE SMALL BUSINESS CONCERNS

OFFERING THE PRODUCTS OF DIFFERENT SMALL BUSINESS CONCERNS AND (B) AWARDS WILL BE MADE AT REASONABLE PRICES." (FAR 19.502-2) THIS RULE IS CONVENTIONALLY KNOWN AS THE "RULE OF TWO," HOWEVER, WE BELIEVE THAT THIS SHORT-HAND TERM IS INADEQUATE TO DESCRIBE THE EFFECT OF THE CURRENT PROCESS. THERE ARE, AS YOU KNOW, SEVERAL TESTS TO BE MET BEFORE SET-ASIDES ARE CREATED. IF WE NEED A DESCRIPTIVE TERM TO REPLACE THE MORE DETAILED LANGUAGE, IT WOULD BE MORE DESCRIPTIVE TO CALL IT THE "ASSURED COMPETITION RULE" SINCE THE PRESENT REGULATIONS REQUIRE SUCH ASSURANCE OF COMPETITION BEFORE A SET-ASIDE CAN BE MADE.

THE PREMISE OF THE OFPP PROPOSAL IS THAT CONFLICT EXISTS BETWEEN THE "RULE OF TWO OR MORE" AND THE COMPETITION IN CONTRACTING ACT OF 1984, WHICH REQUIRES, TO THE MAXIMUM PRACTICABLE EXTENT, THE AWARD OF CONTRACTS THROUGH FULL AND OPEN COMPETITION. I BELIEVE THAT WE, AT SBA, ARE IN AGREEMENT WITH OTHER AGENCIES THAT NO SUCH CONFLICT EXISTS. ILLUSTRATIVE OF THE COLLECTIVE VIEWS ON THIS ISSUE IS THE STATEMENT BY THE AGENCIES IN A RECENT DEFENSE ACQUISITION REGULATION COUNCIL CASE:

> "OUR CONCERN WITH OFPP'S POSITION WITH RESPECT TO THE RULE OF TWO IS THAT IT REFLECTS A FUNDAMENTAL MISAPPLICATION OF CICA'S REQUIREMENTS FOR FULL AND OPEN COMPETITION. THE TERM FULL AND OPEN COMPETITION IS DEFINED IN THE OFPP ACT TO MEAN THAT ALL RESPONSIBLE SOURCES ARE PERMITTED TO SUBMIT SEALED BIDS OF COMPETITIVE PROPOSALS ON THE PROCUREMENT. CICA, AS AMENDED BY P.L. 98-577, RECOGNIZES THAT SMALL BUSINESS SET-ASIDES ARE FULL AND OPEN

COMPETITION. THE LANGUAGE AT ISSUE IN 41 U.S.C. 414 CONTAINS AN INSTRUCTION FOR AGENCIES TO INCREASE THEIR USE OF FULL AND OPEN COMPETITION BY ESTABLISHING POLICIES AND PROCEDURES TO ASSURE THAT THE GOVERNMENT RECEIVES A SUFFICIENT NUMBER OF SEALED BIDS OR COMPETITIVE PROPOSALS TO FULFILL ITS REQUIREMENT AT THE LOWEST REASONABLE COST. IN TERMS OF CICA, THIS MEANS AGENCIES SHOULD USE ADVANCED PROCUREMENT PLANNING, CBD SYNOPSIZING AND SPECIFICATIONS WHICH ARE NOT UNNECESSARILY RESTRICTIVE.(DAR CASE 86-709)."

THE COMPETITION IN CONTRACTING ACT DOES INDEED REQUIRE AGENCY HEADS TO ESTABLISH "POLICIES, PROCEDURES, AND PRACTICES" WHICH WILL ASSURE THAT THE AGENCY "RECEIVES A SUFFICIENT NUMBER" OF OFFERS TO FULFILL GOVERNMENT REQUIREMENTS "AT THE LOWEST REASONABLE COST..." ADDITIONALLY, HOUSE CONFERENCE REPORT NO. 98-861 DOES SAY THAT THE PROVISION APPLIES TO ALL PROCUREMENTS, "INCLUDING THOSE MADE UNDER SET-ASIDE PROGRAMS." IT IS THIS LANGUAGE WHICH LEADS OFPP TO BELIEVE THAT THE "RULE OF TWO OR MORE" MUST BE DELETED FROM REGULATIONS. BUT SUCH LANGUAGE SHOULD BE READ IN CONTEXT. NOT LONG AFTER PASSAGE OF CICA, CONGRESS PASSED THE SMALL BUSINESS AND FEDERAL PROCUREMENT COMPETITION ENHANCEMENT ACT OF 1984 (P.L. 98-577). THIS ACT SIGNIFICANTLY AMENDED THE FEDERAL PROPERTY AND ADMINISTRATIVE SERVICES ACT TO AUTHORIZE THE USE OF SMALL BUSINESS SET-ASIDES, USING COMPETITIVE PROCEDURES. P.L. 98-577 ALSO INCLUDED SET-ASIDES IN THE DEFINITION OF "COMPETITIVE PROCEDURES" WHERE ALL SMALL BUSINESSES ARE PERMITTED TO COMPETE.

THE SMALL BUSINESS SET-ASIDE IS AN IMPORTANT PROCEDURE THROUGH WHICH SMALL BUSINESSES CAN FULLY AND OPENLY COMPETE WITH THEIR PEERS FOR A FAIR PROPORTION OF GOVERNMENT PURCHASES. THIS PROGRAM, CREATED BY THE SMALL BUSINESS ACT OF 1953, HAS BEEN NATIONAL POLICY FOR MORE THAN 30 YEARS. TO RISK WEAKENING THE SET-ASIDE PROGRAM THROUGH IMPLEMENTATION OF THE PROPOSED FAR CHANGES WOULD UNDERMINE THE EFFECTIVENESS OF THE POLICY TO PROVIDE MAXIMUM PRACTICABLE PROCUREMENT OPPORTUNITIES TO SMALL BUSINESS.

IT MAY BE USEFUL TO EXAMINE THE PROGRAMMATIC ASPECTS OF THE SET-ASIDE PROGRAM WITH A GENERAL DISCUSSION OF HOW DOD, THE LARGEST PROCURING AGENCY, PARTICIPATED IN THE SET-ASIDE PROGRAM UTILIZING THE "RULE OF TWO OR MORE":

-- IN THE PAST FIVE FISCAL YEARS, THE DOD HAS AWARDED APPROXIMATELY 50 PERCENT OF ITS SMALL BUSINESS CONTRACT AWARDS TO SMALL BUSINESS AS SET-ASIDES. THESE CONTRACTS WERE SET-ASIDE BECAUSE DOD CONTRACTING OFFICERS RECOGNIZED (1) THE VALUE OF CONTRACTING WITH SMALL BUSINESSES WHO PROVIDE HIGH QUALITY GOODS AND SERVICES AT REASONABLE PRICES, AND (2) THAT THE "RULE OF TWO OR MORE" DOES NOT DELIMIT, CURTAIL OR INHIBIT "FULL AND OPEN COMPETITION." WHAT IT ACTUALLY DOES IS TO CREATE A RATIONAL, QUANTIFIABLE PROCUREMENT ENVIRONMENT IN WHICH CONTRACTING OFFICERS CAN BOTH CONFIDENTLY SERVE THE GOAL OF MAXIMUM PRACTICABLE PARTICIPATION BY SMALL BUSINESS, AND FULFILL THE IMMEDIATE PROCUREMENT REQUIREMENT OF THE BUYING AGENCY.

-- MOST RECENTLY, IN FISCAL YEAR 1985, DOD MADE $139.6 BILLION IN TOTAL CONTRACT AWARDS. OF THIS, $26 BILLION, OR 18.8 PERCENT OF TOTAL AWARDS WERE MADE TO SMALL BUSINESS. DOD REPORTS THAT $14 BILLION, OR 53 PERCENT OF THE $26 BILLION, WAS AWARDED AS SET-ASIDES. BASED ON DOD TOTAL AWARDS, LARGE BUSINESS RECEIVED 81.2 PERCENT VERSUS 18.8 PERCENT AWARDED TO SMALL BUSINESS. THERE IS NO EVIDENCE THAT DOD UTILIZATION OF THE "RULE OF TWO OR MORE" PROCEDURE LIMITED COMPETITION. IN FACT, AN INFORMAL SURVEY WHICH SBA CONDUCTED INDICATED THAT, USING THE CURRENT PROCEDURES, DOD AVERAGES 10 SMALL BUSINESSES BIDDING ON EACH SET-ASIDE; NASA 12; AND GSA, MORE THAN 10. UNRESTRICTED PROCUREMENTS DO NOT BRING IN THIS NUMBER OF BIDDERS IN MOST INSTANCES. THUS, IT APPEARS THAT APPLICATION OF THE RULE IS LEADING TO INCREASED COMPETITION FOR FEDERAL CONTRACTS IN AREAS WHERE SMALL FIRMS ARE EFFICIENT PERFORMERS.

NOTHING IN THE CURRENT SET-ASIDE PROCEDURE RELIEVES ANY AGENCY FROM THE OBLIGATION OF MAKING ITS AWARDS ON SOLIDLY-BASED BUSINESS JUDGMENTS.

APART FROM THE JUSTIFICATION FOR THIS CHANGE IN POLICY, THE IMPLEMENTATION PROPOSED BY OFPP IS PREJUDICIAL TO SMALL BUSINESS. AT PRESENT THE REGULATIONS HAVE A PRESUMPTION IN FAVOR OF SET-ASIDES UNLESS THE CONTRACTING OFFICER MAKES A NEGATIVE DETERMINATION. THE NEW RULE MAKES THE REVERSE PRESUMPTION, REQUIRING WRITTEN DETERMINATIONS EACH TIME. CONTRACTING OFFICERS MAY EASILY READ A MESSAGE IN THAT CHANGE ALONE.

THE UNIFORM ADVICE OF SBA'S PROCUREMENT ASSISTANCE PERSONNEL IS THAT THIS CHANGE WILL MOST CERTAINLY NEGATIVELY IMPACT THE SMALL BUSINESS SET-ASIDE PROGRAM, WHICH AMOUNTS TO APPROXIMATELY HALF OF ALL SMALL BUSINESS AWARDS.

MR. CHAIRMAN, IN YOUR INVITATION LETTER FOR THIS HEARING YOU REQUESTED THAT SBA'S GENERAL COUNSEL PROVIDE OPINIONS ON TWO SUBJECTS: (1) WHETHER THE COMPETITION IN CONTRACTING ACT REQUIRES THE REPEAL OF THE "RULE OF TWO" AND (2) WHETHER OMB PROPERLY INVOKED ITS AUTHORITIES UNDER SECTION 6 OF THE OFFICE OF FEDERAL PROCUREMENT POLICY ACT IN PUBLISHING THE PROPOSED REGULATORY CHANGE ON MAY 22ND. THESE OPINIONS ARE ATTACHED FOR THE RECORD.

YOU ALSO REQUESTED COPIES OF ALL CORRESPONDENCE BY AND BETWEEN SBA, OMB, AND OFPP ON THE SUBJECT OF THE "RULE OF TWO" AND THESE ARE ALSO PROVIDED FOR THE RECORD. THE MOST RECENT OF SUCH CORRESPONDENCE IS A LETTER DATED MAY 28TH FROM ME TO OMB DIRECTOR JAMES MILLER.

THIS CONCLUDES MY STATEMENT, MR. CHAIRMAN. I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

MAY 28 1986

Honorable James C. Miller III
Director
Office of Management and Budget
Washington, D. C. 20503

Dear ~~Mr. Miller~~ Jim:

I am writing to let you know my personal concerns about the Office of Federal Procurement Policy proposal to eliminate the "rule of two." I have reviewed and concur with the letter of my predecessor, Jim Sanders, to Joe Wright dated March 27, 1986 (copy enclosed) which states that the proposal will weaken the small business set-aside program.

As you know, the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration have also voiced concerns over the proposal. I do not believe that Joe Wright's response to Mr. Sanders' letter adequately responds to the many concerns raised by a number of agencies. We will be commenting formally on the proposed rule published in the Federal Register at a later date.

I would be happy to meet with you to discuss this matter at your convenience.

Sincerely,

Charles L. Heatherly
Acting Administrator

Enclosure

MAY 18 1984

Mr. William Maraist
Deputy Associate Administrator
 for Policy Development
Office of Federal Procurement
 Policy
Office of Management and Budget
726 Jackson Place, N. W.
Washington, D. C. 20503

Dear Mr. Maraist:

The Small Business Administration (SBA) appreciates the opportunity to comment on Congressman Brooks' March 14, 1984, letter which opposes the "rule of two" associated with the small business set-aside program.

The Deputy Under Secretary of Defense (Acquisition Management) has very effectively summarized the legal basis and the intent of the set-aside program in her letter dated April 16, 1984. We would point out that the Small Business Act declares a policy of Congress that the Government should aid, counsel, assist and protect the interests of small business concerns in order to preserve free competitive enterprise.

Additionally we would reiterate Ms. Gilleece's observation that two of the four objectives of the Small Business Act, as it relates to the set-aside program, generate benefits that accrue not to the small business community but rather to the Government.

SBA concurs with positions expressed by DOD, GSA and NASA in that definitive, quantifiable guidance is necessary as a firm standard for application throughout Government procuring activities. This position is evidenced by the reasons given by DOD, GSA and NASA as to why a definitive standard was established. As reflected in the DOD letter, small business set-asides generally result in more, not less competition. This increase in competition results because of two factors: (1) there are more small businesses than large businesses and (2) small business firms will be competing against their peers and stand a realistic chance of winning the contract and, therefore, are more willing to compete.

The GSA letter, however, does reflect a misconception as to the applicability of the "rule of two" set-aside provision. GSA perceives the set-aside provision to be applied after a decision to set aside has been made in lieu of the provision being the basis of the determination. The FAR provision represents new policy for former FPR users, in particular Federal civilian agencies like GSA which may be responsible for their misunderstanding. This is a significant factor in that one of the main considerations in specifying the number of small businesses that would warrant a set-aside, was because of wide interpretation of the language of the FPR.

SBA does not agree with the motion that small business set-asides resulted in a disproportionate share of Government contracts to small business. On the contrary, the utilization of the set-aside provision has helped to balance the proportionate share to small business. Without the set-aside provision, there would be an even greater number of small businesses excluded from participation in the Government contract process.

Mr. William Maraist

The comments offered by the "Trade Associations" seem to be no more than self-serving at the least. Reference is made to a Senate Report that implies Congress has specifically expressed its opposition to the DAR total set-aside concept in connection with military construction contracts. A review of Senate Report 97-448 reveals testimony expressed by interested parties rather than any particular opposition by Congress. It should be noted, the viewpoint reflected in the Senate Report is testimony from the architect-engineer community and from several professional engineering societies.

The applicability of the "rule of two" set-aside provision should not be viewed as anything other than a necessary tool for providing clear, concise guidance concerning a workable standard for small business set-asides. The FAR settled on language that was consistent with the DAR and NASA Procurement Regulations to eliminate problems experienced under the FPR as to how many firms constituted a "sufficient number" to warrant a set aside.

Sincerely,

/s/ Donald P. Young

Donald P. Young
Associate Administrator
for Procurement and Technical Assistance

RULE OF TWO IN THE SBA SET-ASIDE PROGRAM

The Small Business Administration (SBA) was established to carry out the policy of Congress that requires the Government to aid, counsel, assist, and protect the interests of small business concerns. In the Federal acquisition arena, the SBA plays a vital role in increasing both the dollar value and percentage of total awards to small and small disadvantaged businesses. The small business set-aside program has proven to be an essential and effective means of assisting small businesses.

Section 15(a) of the Small Business Act provides the authority for establishing small business set-asides whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business...." We would point out that the first two objectives generate benefits that accrue not to the small business community but rather to the Government. The small business set-aside program serves as the foundation of the Federal agencies small business programs.

In carrying out the congressional mandate, the small business program has been implemented by the Federal Acquisition Regulation (FAR) that provides, in part, that an entire acquisition will be set aside exclusively for small business when the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns and (b) awards will be made at reasonable prices. Hence, the "rule-of-two" is established by regulation.

The "rule-of-two" has been used successfully for many years by Department of Defense buying activities. However, the civilian agencies adhered to the language contained in the Federal Procurement Regulations (FPR) which provided that the contracting officer have a reasonable expectation of receiving offers from a "sufficient number" of responsible small business concerns. Needless to say, the phrase "sufficient number" was subject to various interpretations by the myriad contracting officers of the civilian buying activities and resulted in confusion and a non-uniform application of the set-aside acquisition procedures.

The initial version of the FAR did not reflect the "rule-of-two" language because it was based on the FPR. However, as a result of public comments received by OFPP on the proposed FAR (including comments provided by SBA, DOD, GSA, etc.), the language was amended from the "sufficient number" criterion to the widely accepted "rule-of-two" policy.

We should point out that Federal agencies record awards as being competitive whenever offers are received from two or more business firms. This, in effect, established that the test of sufficiency of competition to set aside a procurement for small business firms is satisfied when two or more small firms are expected to submit offers on any given procurement. The FAR at Section 15.804-3(b) reaffirms the "rule-of-two" standard for adequate price competition. We do not believe that we can have one standard for measuring competition in the overall acquisition process and a different standard as to what constitutes competition for a small business set-aside.

We should also note that small business set-asides generally result in more, not less competition. This increase in competition results because of two factors: There are a much greater number of small business firms than big business firms; secondly, the small business community perceives that when a procurement is set-aside, it, by definition, cannot be a sole source award and that they will be competing against their peers and therefore stand a realistic chance of winning the contract.

In summary, we believe that the FAR "rule-of-two" language serves as a workable standard for small business set-asides and provides for the required consistency of application needed across the Government.

JAN 1 1 1985

Mr. William Mathis
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Washington, D. C. 20503

Dear Mr. Mathis:

This is in response to your request that we provide comments on the impact of modifying the so-called "Rule of Two" found in Federal Acquisition (FAR), Section 19.502. As we understand it, the proposed modification would change the FAR language to require that the Contracting Officer determine that there is a reasonable expectation that offers will be obtained from a sufficient number of small businesses at the lowest reasonable cost to ensure free and open competition (emphasis supplied).

This change is thought by some to be indicated because they have concluded that the existing FAR 19.502 is inconsistent with the provisions of Section 2732(b)(2) of the Competition in Contracting Act. At the outset, this Agency takes the position that no such inconsistency exists. We believe that changing or eliminating the guidance to Contracting Officers by the Rule of Two about how to make the threshold decision to set a procurement aside is not dictated by the Competition in Contracting Act.

The proposed change would abolish the rule and result in no guidance at all to Contracting Officers. Based on our experience, we believe that the impact on the set-aside program would be devastating.

Both Congress and the Office of Management and Budget have recently concluded in the spare parts program that once a product or service becomes the exclusive domain of large business as a result of limiting sources and/or competition, the price increases on certain items are unacceptable. Thus, as a matter of public policy, Congress and OMB acted to increase small business participation in the provision of spare parts. By setting certain spare parts procurements aside for small businesses, uncontested savings of hundreds of millions of dollars have resulted. Those savings would be lost if the number of set-asides was reduced because of elimination of the rule.

It is an established fact that once a procurement is set aside, competition is increased. The Department of Defense averages 10 small businesses bidding on set-asides, the National

Aeronautics and Space Administration 12, and the General Services Administration more than 10. Unrestricted procurements do not bring this number of bids in most instances.

The Rule of Two effectively came into being in FY 1981. It was promulgated in July 1979, but because of distribution delays and changes did not have significant impact in FY 1980. Our analysis of DOD data reflects that increases attributable to the impact of the rule were 35.8 percent in FY 1981; 19.0 percent in FY 1982; 4.4 percent in FY 1983; and are projected at over 6 percent in FY 1984. These data reflect percentage increases in the small business share of the DOD procurement dollars in the set-aside program and are adjusted so that small purchase set-asides are not included.

Since the civilian agencies have only been subject to the rule since April 1984, and final FY 1984 data are not available from the Federal Procurement Data Center, we have made no attempt to analyze projected data.

We must conclude that since the above data reflect the greatest increase in small business participation in the program's history in DOD, elimination of the rule will result in substantially reduced set-asides.

This is not to say that the program is free of problems. We believe, however, that the effect of having no guidance to Contracting Officers as to when to set a procurement aside will adversely affect small business participation in Federal Procurement programs. This will have the attendant effect of limiting growth in the industrial base encouraged in the Small Business Act and Public Law 98-577. Further, the return to the Treasury in taxes from small business is generally considered greater because many small businesses pay taxes as individuals without the more favorable corporate rates.

When using numbers to describe competition, the phrase "two or more" as found in Section 19.502 of the FAR is almost universally used. This can be misleading because in most instances there are far more than two small businesses interested in a given procurement. We think that the proposed language is too vague and that using another number would have little or no effect.

There are approaches which would provide a contracting officer flexibility in ensuring free and open competition while preserving the Rule of Two. We think that these alternatives should be examined in establishing policy concerning set-asides. We further believe other independent factors may operate with

the Rule of Two to produce undesired results in certain industries. We suggest an examination of those factors and their effect before eliminating the rule.

We would be happy to participate with the Office of Federal Procurement Policy and the two Councils in reviewing comments on the Rule of Two and working to achieve the goals of increased industrial capacity, free and open competition, and savings to the taxpayers.

Yours truly,

/s/ Irene Castillo for:

James C. Sanders
Administrator

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

March 27, 1986

The Honorable Joseph Wright
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear ~~Mr. Wright:~~ Joe:

I am writing to express my great concern and surprise at the news that the Office of Federal Procurement Policy (OFPP) has forwarded its proposal to eliminate the "rule of two or more." This rule establishes the mechanism through which Federal contracts are set aside for small business competition. I am concerned because of the importance of the rule to agencies in utilizing small business contracts and because of the contrary action on the specific issue taken by the Congress in 1984. I am surprised because of our direct agreement with Bill Mathis last year that the SBA would take action on specific size standards, the real source of the concern with the "rule of two or more," and that OFPP would confer with SBA before any action was taken on this issue. Over the last several months, SBA has taken action on several problem size standards. Nonetheless, OFPP has come out with their proposal without any of the normal or promised consultation with SBA.

The premise for the OFPP proposal is that conflict exists between the "rule of two or more" and the Competition in Contracting Act of 1984, which requires, to the maximum practicable extent, the award of contracts through full and open competition. I think that we are in agreement with GSA, DOD and NASA that no such conflict exists. Illustrative of the collective views on this issue is the statement by the agencies in a recent Defense Acquisition Regulation Council case:

> Our concern with OFPP's position with respect to the "Rule of Two" is that it reflects a fundamental misapplication of CICA's requirements for "full and open competition." The term "full and open competition" is defined in the OFPP Act to mean "that all responsible sources are permitted to submit sealed bids of competitive proposals on the procurement." CICA, as amended by Pub. L. 98-577, recognizes that small business set-asides are full and open competition. The language at issue in 41 U.S.C. 414 contains an instruction for agencies to increase their use of full and open competition by establishing policies and procedures to assure that the Government receives a

sufficient number of sealed bids or competitive proposals to fulfill its requirement at the lowest reasonable cost. In terms of CICA, this means agencies should use advanced procurement planning, CBD synopsizing and specifications which are not unnecessarily restrictive (DAR Case 86-709).

The small business set-aside is an important procedure through which small businesses can fully and openly compete with their peers for a fair proportion of Government purchases. This program, created by the Small Business Act of 1953, has been national policy for more than 30 years. Weakening of the set-aside program through implementation of the proposed FAR changes would undermine the effectiveness of the policy to provide maximum practicable procurement opportunities to small business.

It may be instructive to examine the programmatic aspects of the set-aside program with a general discussion of how DOD, the largest procuring agency, participated in the set-aside program utilizing the "rule of two or more':

-- In the past five fiscal years, the DOD has awarded approximately 50 percent of its small business contract awards to small business as set-asides. These were set-aside awards not because DOD is moved by altruistic considerations, but rather that DOD contracting officers recognize that (1) the value of contracting with small businesses which provide high quality goods and services at reasonable prices, and (2) that the "rule of two or more" does not delimit, curtail or inhibit "full and open competition." What it actually does is to create a rational, quantifiable procurement environment in which contracting officers can both confidently serve the goal of maximum practicable participation by small business, and fulfill the immediate procurement requirement of the buying agency.

-- Most recently, in Fiscal Year 1985, DOD made $139.6 billion in total contract awards. Of this, $26 billion or 18.8 percent of total awards were made to small business. DOD reports that $14 billion or 53 percent of the $26 billion was awarded as set-asides. Based on DOD total awards, large business received 81.2 percent versus 18.8 percent awarded to small business. There is no evidence that DOD utilization of the "rule of two or more" procedure limited competition. In fact, using the current procedures, DOD averages 10 small businesses bidding on set-asides; NASA, 12; and GSA, more than 10. Unrestricted procurements do not bring in this number in most instances. Thus it appears that application of the rule is leading to increased competition for Federal contracts in areas where small firms are efficient performers.

-- Nothing in the rule of two or any other set aside procedure relieves any agency from the obligation of making its awards on solidly based business judgments.

Changing the "rule of two or more" standard to one of "full and open competition" would direct procurement officers to set aside for small business competition any contract where there is a "reasonable expectation that full and open competition exists." No guidelines are offered to contracting officers to make this determination. The result would be uncertain, inconsistent and unpredictable contract procedures.

The proposed change would abolish the rule and is not legally necessary. Based on our experience, I believe the impact to the set-aside program would be devastating. If there are problems in particular categories of procurement, we can help fix them. Elimination of the "rule of two or more" is an unjustified overbroad approach to procurement reform. We would be happy to meet and participate with OFPP and other interested parties, e.g., DOD, NASA and GSA, to further examine your concerns regarding the "rule of two or more."

Yours truly,

James C. Sanders
Administrator

cc: Honorable William A. Taft, IV
David Baker

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 2 1 1986

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Apr 28 2 04 PM '86
OFFICE OF THE
ADMINISTRATOR

Honorable Charles Heatherly
Acting Administrator
U.S. Small Business Administration
Washington, DC 20416

Dear Mr. Heatherly:

This is in response to a letter dated March 27, 1986 from Mr. Sanders concerning the "rule of two." I believe the enclosed questions and answers respond to most of the comments Mr. Sanders had on this proposed FAR revision.

However, there are a couple of issues regarding the purpose and effect of this regulatory change which I believe require clarification. The letter stated that the premise for the proposal is that conflict exists between the "rule of two" and "full and open competition" as expressed in the Competition in Contracting Act of 1984. The proposed change is not based on the "full and open competition" definition but on the following additional requirement of CICA:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. The proposed standard is not, as stated on the last page of Mr. Sander's letter, a "reasonable expectation that full and open competition exists."

It should be emphasized that the proposed regulation change is intended as appropriate implementation of the Competition in Contracting Act and that it is not a statement that the Executive agencies have been conducting anti-competitive procedures in their current small business set-side regulations.

If we can be of further assistance, please contact Mr. William Maraist on 395-3300.

Sincerely,

Joseph R. Wright, Jr.
Deputy Director

Enclosure

QUESTIONS AND ANSWERS REGARDING SMALL BUSINESS SET-ASIDES

Q.1. What is the intended effect of the instruction to agencies to publish a proposed small business set-aside regulation, as issued by OFPP on February 21, 1986.

A.1. The notice is intended to initiate action to replace the current procurement regulation governing small business set-asides in the Federal Acquisition Regulation (FAR) with one that fully implements the Competition in Contracting Act of 1984 (CICA). The current regulation requires that contracting officers set-aside a procurement for exclusive small business participation where "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns, and (b) awards will be made at reasonable prices."

The proposed rule, based upon wording in the statute, abolishes any rule of thumb such as the rule of two and, instead, requires that — in order to set-aside a procurement — contracting officers determine that the agency will receive a sufficient number of sealed bids or competitive proposals from responsible small business sources to fulfill the Government's requirements at the lowest reasonable cost. The "sufficient number" standard is familiar to procurement officers who employed it for years in the civilian agencies before the FAR became effective in 1984. The three procurement regulatory agencies (DOD, GSA, and NASA) have been instructed to initiate the regulatory change by publishing the proposed regulation by March 23, 1986, for a 30-day period for public comment.

Q.2. Will elimination of the "rule of two" end small business set-asides?

A.2. No. Contracting officials will evaluate planned procurements in the same manner under the proposed regulations as they do under the current system. They will evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will review the purchase history of the item or service to determine if it has been previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DOD's utilization of the "rule of two" commenced only about 5 years before the FAR.

Q.3. What is the Administration's position on preferential procurement programs, generally, and on small business set-asides, in particular?

A.3. The Administration has consistently expressed support for programs which promote the development and growth of small businesses. To illustrate: small business set-asides were supported as part of the Administration's Proposal for a Uniform Federal Procurement System submitted to the Congress in February 1982. The legislative proposal which was submitted to implement the proposal served as a basis for the competition provisions of

the Competition in Contracting Act of 1984 (P.L. 98-369), which recognizes small business set-asides as instances of "full and open competition" limited to small business contractors. Moreover, the President signed a proclamation last month declaring a National Small Business Week.

Q.4. If the "sufficient number/lowest reasonable cost" formula is implemented, what will be the effect upon the number of small business set-asides? (Some commenters have stated they will be reduced by 50%.) Shouldn't that be determined before such a regulation is adopted?

A.4. The legal effect of Section 2732 of the Competition in Contracting Act of 1984 imposes the "sufficient number/lowest reasonable cost" formula as a matter of law. The effect on the number of set-asides by adoption of this formula is not a matter which can alter adoption of the formula. Although the precise effect is impossible to calculate, as a practical matter, it does not appear that adoption of the formula will reduce the number of small business set-asides. There may be a temporary reduction until agency contracting personnel become familiar with the revised regulations. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Small Business Act. The regulations will continue to require that contracting officers review acquisitions to determine if they can be set-aside and provide for review of proposed acquisitions by procurement center SBA representatives, and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Q.5. Will adoption of the "lowest reasonable cost" standard give any big business the opportunity to veto or set-aside merely by saying it is interested in submitting an offer?

A.5. No. Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond than large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (P.L. 98-369, the Competition in Contracting Act of 1984, and P.L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business would be substantially lower than that proposed by small business would a set-aside be cancelled. This is the case under current law as well. The GAO has previously upheld cancellation of a set-aside procurement when information bids from large businesses indicated that the small business' price was unreasonable.

Q.6. How could any contracting officer be assured of having the "lowest reasonable cost" if he does not let large businesses bid?

A.6. The answer must be stated and understood in terms of the law that established the requirement. The CICA requires "full and open competition," which means all firms, large and small, must be allowed to compete. This provision would appear to negate small business set-asides. However, CICA very clearly intended not to preclude small business set-asides. Thus, the Act recognized that full and open competition could exist when the competition is conducted solely among small businesses. However, to set a procurement aside, the contracting officer must reasonably foresee that competition conducted solely among small businesses is likely to result in the lowest reasonable cost.

Q.7. Under the proposed rule, if a large business comes forward and shows the contracting officer, through catalogue prices or otherwise, that its price would be substantially lower than the prices offered by small business, will the contracting officer not set-aside the procurement?

A.7. The procurement would probably not be set-aside. However, it is important to know the reason. It is not merely because a large business expressed interest in the procurement. It is because the contracting officer must make awards at "reasonable" prices. This is necessary to protect the Government from paying unreasonable costs. The fear is that with any rule of thumb, particularly one set at only two, contracting officers may apply it automatically and fail to ascertain that there is a real likelihood of bids in the lowest reasonable cost range. If the information supplied by the large business merely showed that it would be competitive with a sufficient number of small businesses that, in themselves, assure competition, the procurement would be set-aside. This response would also hold true under the "rule of two." This regulation also does not allow a bad business decision by the contracting officer. In addition to having "at least two" small businesses, the contracting officer must determine that the competition will result in reasonable prices. If confronted with the same information from the same large business (substantially lower price), the procurement would not be set-aside even under the "rule of two."

Q.8. What will OFPP do if the three regulatory agencies fail to issue the regulation for comment by March 23, 1986? Will it issue a draft policy letter for comment?

A.8. If the regulatory agencies fail to issue proposed regulations by March 23, 1986, OFPP will utilize its regulatory authority under the OFPP Act (41 USC 405) and, as outlined in OFPP Policy Letter 85-1, issue proposed regulations to be implemented in the Federal Acquisition Regulation for 30 days' public comment. We fully expect, however, that such action will not be necessary.

Q.9. Was this proposed regulation discussed, at least informally, with representatives of the small business community (i.e., SBA, SADBUs, appropriate Congressional staff) prior to issuance? If not, why not?

A.9. There was some limited internal discussion with executive branch agencies, including the SBA, prior to OFPP's decision to request the three agencies to

issue the rule. The rule has not yet been issued in final form. Interested parties will have a full opportunity to express their views on the proposed rule for the record.

Q.10 If the CICA is what caused OFPP to issue the proposed instruction, why did OFPP wait over 18 months to do so? Specifically, what triggered this action?

A.10. After its initial review of the provisions of CICA, OFPP did not conclude that a revision of the regulations addressing small business set-asides was required by the statute. However, after criticism that the rule of two had been included in the FAR without providing adequate public notice and opportunity for comment, OFPP published a Notice of Comment on October 12, 1984. 49 Fed. Reg. 40135. Many commenters noted that CICA, which was to become effective on April 1, 1985, evidenced Congress' concern with the continuing legality and appropriateness of the rule of two in set-aside situations. In December 1984, Congresman Jack Brooks and Frank Horton and Senators William Cohen and Carl Levin wrote to the regulatory agencies concerning the proposed FAR implementation of CICA. Among the matters which they pointed out was the fact that "rule of two," contained in FAR Part 19, was not appropriate in view of the language in Section 2732 of CICA regarding "sufficient number" and "lowest reasonable cost." They also stated that it was their intent, as co-sponsors of the legislation, to eliminate the "rule of two." The regulatory agencies disagreed, in a reaponse to the members in August 1985. The matter was raised again in December 1985, by a letter from Congressmen Jack Brooks and Frank Horton to Joseph Wright, Deputy Director of OMB, asserting their view that the "rule of two" was contrary to the CICA. After considering the comments on the October 1984 notice of comment and the provisions of CICA, OFPP decided to issue for public comment proposed regulations substituting the "sufficient number/lowest reasonable cost" formula in CICA for the "at least two/reasonable price" formula in the current FAR.

Q.11. Does the proposed approach apply to 8(a) firms — and the process by which they are awarded contracts? If not, why not?

A.11. The proposed approach will not apply to firms which are awarded subcontracts under Section 8(a) of the Small Business Act. It should be noted that Section 8(a) of the Small Business Act authorizes the Small Business Administration to enter into direct contracts with Federal agencies to provide goods and services by subcontracting the actual performance to small business firms which have been accepted into the business development program established by the Act. The regulations and procedures for 8(a) contracts and subcontracts are separate and apart from those governing small business set-asides and are unaffected by the OFPP notice.

Only if a firm which is included in the 8(a) program seeks direct procurements independent of the program, would it be subject to the standard FAR provisions, including the set-aside regulations.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

MAY 28 1986

Honorable James C. Miller III
Director
Office of Management and Budget
Washington, D. C. 20503

Dear ~~Mr. Miller~~ Jim:

I am writing to let you know my personal concerns about the Office of Federal Procurement Policy proposal to eliminate the "rule of two." I have reviewed and concur with the letter of my predecessor, Jim Sanders, to Joe Wright dated March 27, 1986 (copy enclosed) which states that the proposal will weaken the small business set-aside program.

As you know, the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration have also voiced concerns over the proposal. I do not believe that Joe Wright's response to Mr. Sanders' letter adequately responds to the many concerns raised by a number of agencies. We will be commenting formally on the proposed rule published in the Federal Register at a later date.

I would be happy to meet with you to discuss this matter at your convenience.

Sincerely,

Charles L. Heatherly
Acting Administrator

Enclosure

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Date: JUN 3 1986

To: Monika Edwards Harrison
Associate Administrator for Procurement Assistance

From: Robert B. Webber
General Counsel

Subject: Office of Federal Procurement Policy Proposal to Amend the Federal Acquisition Regulations to repeal the "Rule of Two" for Small Business Set-Aside Procurements

This is in response to your request for this Office's opinion on two matters relating to the above-referenced matter: (1) whether the Competition in Contracting Act (hereafter "CICA") of 1984 requires the repeal of the "rule of two" as it appears in the Federal Acquisition Regulation (FAR) at Sections 19.501(g) and 19.502-2, and (2) whether the Office of Federal Procurement Policy (hereafter "OFPP") exceeded its authority in issuing the above-reference proposed rule. For the reasons outlined in detail below, we conclude that the CICA does not mandate the repeal of the rule of two, and, in consequence, the OFPP lacks authority under the Office of Federal Procurement Policy Act (hereafter "OFPPA") to promulgate the instant regulation.

BACKGROUND

On May 22, 1986, OFPP caused to be published in the Federal Register a proposed rule amending 48 CFR Parts 6 and 19 which would repeal the "rule of two" and substitute for it language requiring that the contracting officer have a reasonable expectation that he or she will receive a "sufficient number" of offers "to fulfill the Government's requirements . . . at the lowest reasonable cost." This language is derived from an amendment made by CICA to section 16(1) of the OFPPA. OFPP argues in the preamble to this proposed rule that the language contained in section 16(1) should be read to further explain the level of competition required in Federal procurement, thus qualifying the amendments made by CICA to the Federal Property and Administrative Services Act of 1949 (hereafter "FPASA"), the Armed Services Procurement Act (hereafter "ASPA").

OFPP argues that the "rule of two" for small business set-asides, as contained in the FAR, is inconsistent with this language. Because the FAR council, composed of representatives of the Department of Defense, the General Services Administration and the National Aeronautics and Space Administration, has refused to amend the FAR to repeal the "rule of two," OFPP asserts that it is authorized pursuant to section 6 of OFPPA to itself propose the amendment to FAR.[1]

The "rule of two" is currently found in 48 C.F.R. §19.502-2, which provides:

> The entire amount of an individual acquisition or class of acquisitions . . . shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices.

Once a procurement is set aside pursuant to this authority, future procurements of the same product or service is to be continued as a set aside, if required by agency regulations, unless "the contracting officer determines that there is not a reasonable expectation that (1) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and

---

[1] Section 6(b) of OFPPA, as amended, authorizes OFPP "In any instance in which the Administrator determines that the Department of Defense, the National Aeronautics and Space Administration, and the General Services Administration are unable to agree on or fail to issue Government-wide regulations, procedures and forms in a timely manner, the Administrator [of OFPP] may, with due regard for applicable laws and the program activities of the executive agencies and consistent with the policies and functions set forth in this Act, prescribe Government-wide regulations, procedures and forms which shall be followed by executive agencies. . . ." 41 U.S.C. §405(b).

(2) at least two responsible reasonable prices." 48 C.F.R. §19.501(g).

The "rule of two" is a longstanding Government procurement policy. As noted in the OFPP notice of proposed rulemaking, this rule was incorporated into the now superceded Defense Acquisition Regulations (DAR) some five years before it was included in the Federal Acquisition Regulations (FAR). The OFPP discussion fails to note, however, that the policy was first adopted by the Department of the Navy in 1947, and gradually was adopted by the other elements of the Department of Defense over the years, leading to its adoption as department-wide policy in 1979. The FAR council elected to adopt the "rule of two" as Government-wide policy when it proposed the FAR and, consequently, it became such as of April 1, 1984, the effective date of the FAR.

The "rule of two" ought also to be considered in light of the policies contained in the Small Business Act and its predecessor statutes, which have since 1953 provided that

> It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for

> the Government (including but not limited to contracts or subcontracts for maintenance, repair, and construction) be placed with small business enterprises. . . ."[2]

This policy is implemented by 15 U.S.C. §644(a) which provides in pertinent part that "small business concerns within the meaning of this Act shall receive any award or contract or any part thereof . . . as to which it is determined by the Administration and the contracting, procurement or disposal agency . . . to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small-business concerns . . . ."[3] These provisions of the Small Business Act are the statutory predicate for the small business set-aside provisions contained in the above-referenced sections of the FAR.

The authority contained in the Small Business Act is granted without regard for the need for competition in placing contracts with small businesses for purposes of accomplishing the stated Congressional objective. Consequently, unless and only to the extent that the Competition in Contracting Act or some other legislation specifically requires competition greater than that assured by the "rule of two" is any such greater degree of competition required.

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[2] Comparable language was contained in section 202 of the Small Business Act of 1953, 15 U.S.C. §631 (Supp. V 1952). 15 U.S.C. §631.

[3] Comparable provisions were contained in the Small Business Act of 1953, 15 U.S.C. §641(g) (Supp. V 1952); in the Act of September 8, 1950, establishing the Small Defense Plants Administration, 50 U.S.C. App. §2163a(e)(10) (1952); and in the Small Business Mobilization Law, 50 U.S.C. App. §1101 (1946).

Issue I

Does the CICA
Mandate Repeal Of the Rule Of Two

ARGUMENT I

CICA was not intended to alter the procedures used by Executive agencies to determine whether to set aside a procurement for small business

CICA[4] amended FPASA, ASPA, OFPPA, and the Budget and Accounting Act of 1921. The primary purpose of the Act was to impose a statutory standard of "full and open competition" for all Government contracting. This policy objective was incorporated into both FPASA and ASPA.

Section 303(a)(1) of FPASA, as amended by section 2711 of CICA, now provides:

> (a)(1) Except as provided in subsections (b), (c), and (g) and except in the case of procurement procedures otherwise

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[4] CICA was enacted on July 18, 1984, as title VII of the Deficit Reduction Act of 1984 (Pub. L. 98-369, 98 Stat. 1175).

> expressly authorized by statute, an executive agency in conducting a procurement for property or services -
> (A) shall obtain full and open competition through the use of competitive procedures in accordance with the requirements of this title . . . .
> (B) shall use the competitive procedure or combination of competitive procedures that is best suited under the circumstances of the procurement. (Emphasis supplied)

By using this language, Congress intended not only that the Executive agencies use competitive procedures in making procurements of goods and services, but also that they increase the effectiveness of such competitive procedures by enhancing the ability of potential offerors to compete. The Senate Committee on Governmental Affairs explained what it meant by "effective competition" as follows:

> Five components characterize 'effective competition': (1) the information required to respond to a public need is made available to prospective contractors in a timely fashion; (2) the government and contractor act independently; (3) two or more contractors act independently to respond to a public need by offering property or services which meet that need; (4) the government has expressed its need in a manner which promotes competition; and (5) there is no bias or favoritism, other than required by law, in the contract award. S. Rept. No. 50, 98th Cong., 1st Sess. 18 (1983).

It is clear from this passage that what Congress was attempting to accomplish by means of CICA was to proscribe anti-competitive practices of Executive agencies, such as restricted distribution of solicitation documents, advance discussions between contracting officers and a few select potential offerors; sole-source procurements other than those authorized by law; the use of restrictive specifications; and other practices designed to limit the ability of potential offerors to compete for Government procurement contracts. In light of the emphasized language, it is also clear that Congress considered competition between two or more entities to satisfy the requirement of "full and open competition."

Congress sought to give effect to this objective of "effective competition," in part, by imposing the standard of "full and open competition" on Executive agencies as the general rule and by defining "full and open competition" as meaning: "that all responsible sources are permitted to submit sealed bids or competitive proposals on the procurement . . . ."[5]

This broad definition of "full and open competition" is qualified by other provisions of CICA. In this regard, Congress explicitly recognized that Executive agencies were permitted under other authority to restrict the range of business concerns eligible to compete for individual solicitations or classes of solicitations. Section 303(b)(2) of FPASA, as amended by 2711(a) of CICA, provided: "In fulfilling the statutory requirements relating to small business concerns and socially and economically disadvantaged small business concerns, an executive agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to compete." This section was subsequently revised by section 504(a)(1) of the Small Business and Federal Procurement Competition Enhancement Act of 1984 (hereafter "SBFPCEA"), Pub. L. 98-577, to read: "An executive agency may provide for the procurement of property or services covered by this section using competitive procedures, but excluding other than small business concerns in furtherance of sections 9 and 15 of the Small Business Act (15 U.S.C. 639; 644)."

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[5] "Full and open competition" is defined at section 309(c) of FPASA, as added by section 2711 of CICA, by reference to "the . . . meanings provided such terms in section 4 of the Office of Federal Procurement Policy Act (41 U.S.C. 403)." The term is there defined as quoted above.

The Senate bill, S. 388, from which CICA was derived, did not expressly recognize small and disadvantaged small business set asides as a permissible competitive procurement method. The conference committee on the Deficit Reduction Act of 1984 added the amendment to section 303(b)(2) of FPASA

> to give more precise recognition to set-aside programs authorized by statute . . . . Congress has historically provided assistance through the Federal procurement process to small businesses. In recognition of this policy,

> the conferees include a provision in the conference substitute which authorizes agencies to limit competition to small business concerns or socially and economically disadvantaged small business concerns as long as all such firms within the categories are allowed to compete." H. Conf. Rept. No. 861, 98th Cong., 2d Sess. 1424 (1984) (emphasis supplied).[6]

These passages make clear the effect Congress intended CICA to have on small business set-asides. Congress intended to introduce an express requirement that once a solicitation was set aside for small business, the procuring agency was required to take action to maximize the opportunities of eligible small and disadvantaged small business concerns to submit offers, i.e., to compete for that contract.

In proposing the amendment to the "rule of two," we believe that OFPP is attempting to apply CICA in a manner and to a policy that Congress never intended to disturb. As discussed above, CICA was intended to introduce the concept and practice of full and open competition into Government procurement. What that meant was that Executive agencies were to forebear from any actions that would restrict the ability of any qualifying business entity to submit an offer in response to any solicitation issued. There is no evidence, direct or otherwise, that Congress also intended by this Act to affect the policies and procedures by which an Executive agency determined what would be a qualifying entity. We do not read the amendment made to subsection 16(1) of OFPPA as evidencing such an intent.

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[6] This emphasis on maintaining full and open competition within small business set-asides was emphasized by the subsequent amendment of the definition given to the phrase "competitive procedures" by the SBFPCEA. Section 504(a)(3) of SBFPCEA further amended section 309(b) of FPASA to add to the definition of competitive procedures: "procurements conducted in furtherance of section 15 of the Small Business Act (15 U.S.C. 644) as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete." (Emphasis supplied).

Subsection 16(1) of OFPPA, as amended by section 2733 of CICA, requires that the heads of executive agencies establish policies, procedures and practices that will ensure that competition is encouraged as much as possible. This was done in order that the agency will be able to choose from as large a number of bids as can be generated, and so, arguably, be able to obtain the lowest reasonable price.[7] The emphasis is on developing policies, procedures and practices that will foster competition in each agency's procurement program.

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[7] Section 2733 of CICA, amending section 16(1) of OFPPA, 41 U.S.C. 414(1), provides:

> . . . the head of each Executive agency shall in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
> (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements . . . at the lowest reasonable cost considering the nature of the property or services procured.

The amendment to subsection 16(1) was added by the conference committee on the Deficit Reduction Act of 1984, and was intended by that committee to require

> agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs. H. Conf. Rept. No. 861, 98th Cong., 2d Sess. 1434 (1984).

There is no evidence that Congress intended this amendment to disturb the "rule of two," the policy by which Executive agencies Government-wide determine whether to restrict the range of entities eligible to compete under a solicitation or class of solicitations to small business or disadvantaged small business concerns. Reading this amendment consistent with the over-arching purpose of CICA as discussed above, leads to the conclusion that Congress likely included this provision in order to make agency heads personally accountable for improving competition in their agencies' procurement programs. There is no evidence that Congress intended by this provision to introduce a particular level of competition for purposes of determining whether a small or disadvantaged small business set-aside may be made. In fact, what evidence there is supports a contrary conclusion. By expressly recognizing small business set-asides as a permissible limitation on the range of entities eligible to compete, Congress let it be known that it was aware of and approved of the practice of making such set-asides. In specifically addressing this question, both in CICA and in SBFPCEA, Congress took no action to express any displeasure with the procedures by which decisions to make set-asides to small and disadvantaged small businesses were reached. Since it specifically considered the issue, Congress' failure to act to amend the procedure for determining whether a set aside is appropriate may be read as tacit assent to and acceptance of the then current procedures, including the "rule of two."

ARGUMENT II

CICA must be read to the extent possible to be consistent with other statutes concerning Federal procurement policy and procedures

The approach taken by OFPP reads the amendment to subsection 16(1) of the OFPPA outside the context of CICA itself and other statutes governing Executive agency procurement activities. When read consistent with those other provisions, it is clear that Congress did not intend the language "sufficient number" of offerors to require a finding that more than two offerors are likely to submit bids.

Section 303(a)(2) of FPASA, as amended by CICA, provides that a reasonable expectation of receiving "more than one" bid, i.e., two or more, is an acceptable number of bids for purposes of deciding to proceed with a sealed bid solicitation.[8] We construe this language as indicating that Congress considered an expectation of receiving more than one bid in such context as constituting a "sufficient number of bids" and, consequently, adequate competition.

Inasmuch as sealed bid solicitations may be used in the context of a small business set-aside, OFPP's proposal would impose a higher competition threshold for small business set-asides using sealed bidding than CICA imposed upon nonset-aside procurements using the same competitive procedure. Absent some clear indication to the contrary, there is no reason to infer that Congress intended to establish a different competition threshold for set-asides as compared to nonset-aside sealed bidding. Consequently, Congress' establishment of "more than one" offeror for sealed bidding is strongly indicative that the "rule of two" would meet the overall purpose of Congress in enacting CICA to increase competition in Federal procurement. This conclusion is buttressed by the language quoted from S. Rept. No. 50, in Argument I above. There, the Senate Governmental Affairs Committee expressly indicated that receipt of bids from two or more entities would be indicative of "effective competition," the objective Congress sought to obtain in passing CICA.

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[8] FPASA section 303(a)(2), as amended by CICA section 2711, provides:

> In determining the competitive procedures appropriate under the circumstance, an executive agency --
> (A) shall solicit sealed bids if --
>   (i) time permits the solicitation, submission, and evaluation of sealed bids;
>   (ii) the award will be made on the basis of price and other price-related factors;
>   (iii) it is not necessary to conduct discussions with the responding sources about their bids; and
>   (iv) there is a reasonable expectation of receiving more than one sealed bid; and
> (B) shall request competitive proposals if sealed bids are not appropriate under clause (A). (Emphasis supplied).

At the time CICA was enacted, the "rule of two" had been Navy policy for nearly thirty years, DOD policy for approximately five years and had been adopted in the FAR as Government-wide policy. It seems fair to assume that Congress was aware of that rule. It also seems fair to assume that the various affected Executive agencies would continue to follow the rule in determining when to set aside contracts for small business in light of Congress' express approval of small and disadvantaged small business set-asides in the short list of recognized competitive procedures included in CICA. Congress revisited this issue only four months later in enacting the technical amendments to CICA in Title 5 of SBFPCEA. There it reiterated that small business set-asides made under either section 9 or 15 of the Small Business Act should be considered competition, albeit restricted competition, without expressing any dissatisfaction with the "rule of two" in either context. This lends further support to the conclusion that Congress considered "two or more" offerors in a small business set-aside context to constitute a "sufficient number of sealed bids or competitive proposals" to satisfy the requirements of section 16(1) of OFPPA.

Moreover, Congress had earlier recognized the adequacy for purposes of competition, of at least two bidders in the context of small purchase, small business set-asides authorized under section 221(j) of Public Law 95-507, October 24, 1978. There, in an effort to increase the percentage of the Federal procurement dollar earned by small businesses, Congress required that "contracts of less than $10,000 be reserved exclusively for small business unless the contracting officer cannot obtain offers from two or more small businesses that are competitive in terms of price, quality, and delivery of the goods or services being purchased." S. Rept. No. 1070, 95th Cong., 2d Sess. 17 (1978) (emphasis supplied). These small purchase, small business set-asides are a comparable form of small and disadvantaged small business set-aside. Here again, Congress has explicitly recognized that anticipated bids from two or more small business concerns is sufficient competition to support a decision to go forward with the set-aside.

ARGUMENT III

CICA must be read to the extent possible to give maximum effect to section 15 of the Small Business Act

The longstanding policy of the Federal Government, as enunciated in the Small Business Act, has been that a "fair proportion" of Federal contracts should be placed with small business concerns. Federal law and regulations have for many years directed that small business set-asides be used as a means of achieving that fair proportion. See Background discussion above. The proposal made by OFPP, in addition to modifying the "rule of two" would also undermine that portion of section 15 of the Small Business Act authorizing class small business and disadvantaged small business set asides.

Under the proposed rule, a contracting officer would be required to make detailed findings and determinations for each procurement he or she proposed to set aside for small business.[9] As a result of the change proposed in 48 C.F.R.

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[9] Under the revised 48 C.F.R. §19.501-2, "The contracting officer's determination must demonstrate that under set aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of

(Footnote continued to page 18)

§19.501(g), class set-asides, as authorized by section 15 of the Small Business Act,[10] 15 U.S.C. §644, would become indistinguishable from individual set-asides.

Under the current rule, once a class set-aside determination has been made, unless the contracting officer concludes that bids from at least two concerns will not be received or that the procurement cannot be obtained through the set-aside at a reasonable price, the procurement of that good or service will continue as a set-aside. 48 C.F.R. §19.501(g). Under the proposed rule, this presumption of continuation of the set-aside is reversed. Unless the contracting officer reaffirms the original determination for each subsequent procurement within the "class" set-aside, the procurement must be removed from the set-aside program. 51

(Footnote continued from page 17)
sufficiency will vary, taking into account the size character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history or (sic) an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition consistent with the provisions of 41 U.S.C. 414 can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above." 51 Fed. Reg. 18811 (May 22, 1986) (emphasis supplied).

[10] Section 15(a) provides: "These determinations [to make set-asides] may be made for individual awards or contracts or for classes of awards or contracts."

Fed. Reg. 18811 (May 22, 1986). The consequence of this change is to convert class set-asides to a series of individual set-aside actions. We believe that this controverts the intent and clear meaning of section 15 of the Small Business Act.

The rule of two is a tested mechanism for initiating a small business set-aside and achieving the full and open competition required by law. Full and open competition requires that all eligible offerors are permitted to submit offers for the procurement. The "rule of two" does not limit competition in this regard. Competition is limited only to the extent that the procurement is limited to qualifying small or disadvantaged small business concerns. CICA expressly recognizes this as a legitimate limitation on competition. The "rule of two" sets a minimum level of competition, consistent with the competition requirements elsewhere established by the Congress. It also facilitates accomplishment of the policies contained in the Small Business Act, to assure that a fair proportion of Government procurement goes to small business. There is nothing in CICA, or its legislative history, to indicate that Congress intended to repeal the "rule of two" by its enactment.

ISSUE II

Did OFPP Properly Invoke its Authority to Publish the Proposed Regulatory Change to the "Rule of Two"?

Argument I

OFPP lacks authority to promulgate a Government-wide regulation unless a statue requires such regulation and the responsible agencies cannot agree or fail to act in a timely manner

Subsection 6(b) of the OFPP Act, 41 U.S.C. 405(b), provides that:

> "In any instance in which the Administrator [of the OFPP] determines that the Department of Defense, the National Aeronautics and Space Administration, and the General Services Administration are unable to agree on or fail to issue Government-wide regulations, procedures and forms in a timely manner, the Administrator may, with due regard for applicable laws and the program activities of the executive agencies and consistent with the policies and functions set forth in this Act, prescribe Government-wide regulations, procedures and forms which shall be followed by executive agencies in the procurement of [property and services].

The OFPP cites this subsection as authority for its proposal to implement a new Government-wide procurement policy to repeal the "rule of two." We believe that this subsection fails to provide the requisite authority to repeal the "rule of two."

First, the "rule of two" establishes a threshold requirement to ensure competition. It is not inconsistent with CICA. Thus, CICA did not require or authorize DOD, NASA, and

GSA to issue Government-wide regulations or procedures relating to a "sufficient number" of offers and the "rule of two." Consequently, the necessary statutory predicate for OFPP to prescribe Government-wide regulations or procedures does not exist in this instance.

Second, DOD, NASA and GSA are not unable to agree on what policy should prevail. All are in agreement that the "rule of two" should remain intact.

Third, DOD, NASA and GSA have not failed to issue Government-wide regulations in a timely manner. No single executive agency or group of executive agencies was given authority by CICA to establish Government-wide policies, procedures or regulations to implement the amended subsection 16(1) of the OFPP Act, 41 U.S.C. 414(1). Individual agencies were given discretion to establish those policies and procedures necessary to ensure competition in each agency's procurement practices by being able to consider the nature of the property or services procured. Congress did not give OFPP, through subsection 16(1), the power to usurp the authority given to the heads of all executive agencies to implement appropriate procurement policies and procedures in their agencies.

ARGUMENT II

Subsection 16(1) of OFPPA does not authorize or mandate the issuance of any Government-wide regulations

Section 2732 of CICA, amended subsection 16(1) of the OFPP Act, 41 U.S.C. 414(1), to read as follows:

> To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices - (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. (Emphasis supplied).

This subsection does not give any single executive agency (e.g., the Office of Management and Budget or the OFPP), or group of agencies (e.g., DOD, NASA, and GSA, collectively), the authority to promulgate regulations or establish policy Government-wide. On the contrary, it empowers "the head of each executive agency" to establish "policies, procedures, and practices" in connection with "the procurement of property or services by

[that] executive agency." This provision would authorize individual executive agencies to supplement the FAR as it relates to their procurements. Any such supplement would, however, be required to be "in accordance with applicable laws, Government-wide policies and regulations, and good business practices." Consequently, until the FAR is amended by regulatory action or overruled by statute as it concerns the "rule of two," any action by a head of an Executive agency under this authority would need to be consistent with that rule.

OFPP does not propose to utilize the above-quoted provision of CICA as authority to establish procedures and regulations for its own procurements. OFPP cites this provision as its authority for unilaterally establishing Government-wide policy that would repeal the "rule of two." Such an attempt on the part of OFPP is not supported by the cited authority.

ARGUMENT III

OFPP failed to consult with the Small Business Administration, as required by section 222 of Pub. L. 95-507, before issuing this proposed rule

Section 405a of Title 41, United States Code, codifying section 222 of Pub. L. 95-507, requires OFPP, in formulating uniform Federal procurement regulations and procedures, to conduct, in consultation with the Small Business Administration, "analyses of the impact on small business concerns resulting from revised procurement regulations." SBA was not consulted regarding OFPP's proposal to repeal the "rule of two" prior to its publication in the Federal Register, and has no knowledge whether the required analyses were in fact conducted.

Conclusion

In summary, we conclude that the CICA does not mandate repeal of the "rule of two" and, further, OFPP exceeded the authority granted it by subsection 6(b) of its organic act in proposing the instant proposed revision to that rule.

Robert B. Webber
General Counsel

Mr. MITCHELL. Thank you. I appreciate it. And you joined the long list of other agencies that take the same position.

Let me just put one or two questions to you. In my original letter of invitation, I asked the SBA to estimate what effect the adoption of the proposed regulation would have on the share of Federal prime contract dollars received by small businesses.

In addition, I asked that you detail in your statement for each of the last 15 years, the dollar amount of prime contracts received by small business, and the percent of such awards awarded under set-asides. I don't think that in your statement, you included that statistical data. Was there not sufficient time to get it together?

Mr. HEATHERLY. Not sufficient time, but we'll be happy to provide as much of that data as we can collect.

[The requested data follows:]

FISCAL YEAR	PRIME CONTRACT AWARDS TO SMALL BUSINESS	% SET-ASIDE TO TOTAL SMALL BUSINESS AWARDS
71	$ 7.7	Not available.
72	8.7	26.7%
73	9.4	27.0
74	10.3	22.5
75	12.7	25.0
76	12.4	25.7
77	16.0	26.9
78	19.2	26.6
79	19.6	26.6
80	21.5	33.6
81	24.6	43.1
82	28.1	45.2
83	28.4	50.2
84	33.0	47.3
85	33.1	48.6

Upda[illegible] 3/27/86

PRIME C[illegible]ACTS STATISTICS

($s ROUNDED TO NEXT HU[illegible] BILLION)

DEPARTMENT OF DEFENSE

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
TOTAL DOD AWARDS	38.2	39.0	47.1	54.4	58.5	66.7	87.2	102.5	121.1	124.9	139.6
AWARDS TO SMALL BUSINESS	7.9	8.1	9.5	10.7	12.2	13.6	17.8	20.1	22.8	23.8	26.0
PERCENT TO SMALL BUSINESS	20.6	20.8	20.2	19.7	20.8	20.4	20.4	19.7	18.8	19.1	18.7
SET-ASIDE DOLLARS	2.3	2.3	2.9	3.4	4.1	4.8	8.3	10.0	11.7	12.4	14.0
% SET ASIDE TO TOTAL AWARDS	6.0	5.9	6.2	6.2	7.0	7.2	9.5	9.8	9.7	9.9	10.0
% SET ASIDE TO TOTAL SB AWARDS	29.1	28.4	30.5	31.8	33.6	35.3	46.6	49.7	51.3	52.1	53.8

CIVILIAN AGENCIES

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
TOTAL CIVILIAN/AGENCY AWARDS	16.4	15.7	20.8	24.4	23.9	24.4	26.3	29.7	27.2	30.2	40.0
AWARDS TO SMALL BUSINESS	4.8	4.3	6.5	8.5	7.4	7.9	6.8	8.0	5.6	9.1	7.1
PERCENT TO SMALL BUSINESS	29.2	27.5	31.3	34.6	31.0	32.4	25.8	26.7	20.6	30.2	17.8
SET-ASIDE DOLLARS	.88	.89	1.4	1.7	1.7	2.4	2.3	2.7	2.5	3.1	2.7
% SET ASIDE TO TOTAL AWARDS	5.4	5.7	6.7	7.0	7.1	9.8	8.7	9.1	9.2	10.3	6.7
% SET ASIDE TO TOTAL SB AWARDS	18.3	20.7	21.5	20.0	23.0	30.4	33.8	33.7	44.6	34.1	38.0

TOTAL ALL AGENCIES

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
TOTAL FEDERAL PROCUREMENT	54.6	54.7	67.9	78.8	82.4	91.1	113.5	132.2	148.3	155.1	179.6
DOLLAR AWARDS TO SMALL BUSINESS	12.7	12.4	16.0	19.2	19.6	21.5	24.6	28.1	28.4	33.0	33.1
PERCENT TO SMALL BUSINESS	23.2	22.7	23.6	24.4	23.8	23.6	21.6	21.3	19.1	21.2	18.4
SET-ASIDE DOLLARS	3.2	3.2	4.3	5.1	5.8	7.2	10.6	12.7	14.2	15.6	16.7
% SET ASIDE TO TOTAL AWARDS	5.9	5.8	6.3	6.5	7.0	7.9	9.3	9.6	9.6	10.1	9.3
% SET-ASIDE TO TOTAL SB AWARDS	25.0	25.7	26.9	26.6	26.6	33.6	43.1	45.2	50.2	47.3	48.6

Source: Reports from Departments and Agencies and the Federal Procurement Data System

Mr. Mitchell. The proposed elimination of the Rule of Two was advanced without really collecting hard data as to the negative impact, and I think it's our responsibility to deliver that data.

Mr. Heatherly. We cannot ascertain, with certainty, the impact of that change. It's somewhat speculative. However, from our experience with the program, and from informal discussions with procurement officers at other agencies, both in Washington and outside of Washington, we are of the unanimous opinion that this would have a negative impact on the procurements going to small business.

The measurement of that, or the estimation of that, is difficult but it certainly would be negative.

Mr. Mitchell. I think that was the consensus of all the persons who testified representing the other agencies. I know it's hard to give a precise figure, but on page 6 of your statement, you indicate the uniform advice of SBA's procurement assistant personnel is that this change will most certainly negatively impact small business set-aside programs which amounts to approximately one-half of all small business awards.

That's an accurate quote, isn't it?

Mr. Heatherly. Yes.

Mr. Mitchell. I wanted to reemphasize that simply because there are those who would say that without the Rule of Two, small businesses would still get a fair share, and I think that's totally wrong and incorrect. I don't think we'd get a fair share if we did not have the Rule of Two.

Mr. Heatherly. Small businesses are also getting a share of the competitive procurements as well, in approximately equal amounts. We can speculate that some of those procurements presently won under the set-aside program would be won in non-set-aside conditions. We do not believe there would be a one-to-one ratio, however. There would be some negative impact.

Mr. Mitchell. Thank you.

Now, I just have one other question, which always leads me into trouble with SBA. It seems to me that a part of the opposition to the Rule of Two, maybe just a small part of it, relates to size standards. We've been struggling for years to try to get an ascertainment of size standards.

Where are we on that, now?

I tried on the committee to get a size standard bill passed; I'm going to try again, because I think it's imperative that we do it. I'm just not going to let up on that fight. I will not, of course, press for the legislation, if SBA can come up with a new size standard definition.

Could you tell me where we are on that within the Administration?

Mr. Heatherly. Well, as the committee will recall, my predecessor testified on your proposed bill last August 1, and indicated that we were undergoing a very serious in-house study of this. The product of that study was transmitted to the committee in the fall, in the form of some proposed guidelines. And, although we've had no formal written feedback from the committee, we've had some informal discussions with your staff which indicated that they were not satisfied with these guidelines.

Yet we continue to apply basically those criteria that we had developed in that process. This issue of size standards, Mr. Chairman, is a very complex one, with a convoluted history. I have been delving into it in the past few weeks in my role as Acting Administrator. I have had briefings by the staff, have read previous testimony and internal guidelines and so forth. I think that it's really a policy decision, not an administrative decision, as to whether we want to concentrate our set-aside program on the smaller of the small firms, or retain size standards that maximize the potential procurement awards within the agencies where the awards are made.

I think it's a tradeoff. I don't think we can have our cake and eat it, too. I don't think we can revise the size standards downward uniformly and retain the percentage and volume of the set-asides now going to small business. If the Congress, in its wisdom, wishes to mandate across-the-board reductions in size standards, the agency will comply with that.

We have tried to use formulas and criterias which recognize the original intent of the set-aside legislation, which was to promote the health of the economy by preserving and maintaining a healthy small business sector through access to Federal procurement.

The issue of what is a fair percentage or a fair proportion of procurements is a subjective and political decision. It's not an administrative or scientific one. The agency has struggled with this over the years, and we have assessed it many times in the last 5 years.

We have proposed various general approaches to it which have then incurred congressional criticism. For example, when we attempt to reduce a size standard, any size standard, without exception, the majority of public comment is always negative, because the people who are being omitted under the new size standard are the first ones to complain. Those who are going to benefit by the lower size standard are not as quick or as uniformly active in their statements of support.

So we have this dilemma of some sympathy in the agency for lower size standards, and yet, there does not seem to be a consensus in the Congress or in the procurement community on this. We incur considerable criticism every time we attempt to do this.

Mr. MITCHELL. Thank you. I think that in the last bill that we had before the committee, we resolved almost all problems with different categories of business with regard to size standards, and the last hangup was with the dredging industry. I'd hoped that we'd resolved that. This Member in his wisdom—you said, the Congress in its wisdom—this Member in his wisdom, thought that we could define fair and equitable size standards, and apparently that was the only real issue in the last bill, the matter of the dredging outfits.

We'll keep trying. I was thwarted in my last attempt, wasn't I, Andy?

Mr. IRELAND. Yes, indeed.

Mr. MITCHELL. However, we shall try again.

Do you have any questions of Mr. Heatherly?

Mr. IRELAND. Well, I wasn't thinking, Mr. Chairman.

While we're on size standards, I would say, your answer, Mr. Heatherly, I thought, was a good one that goes to the heart of the problem, and outlines, for the record, what the problem is.

I guess, obviously, I took a different view of the size standard morass than the chairman, that feeling that indeed, the problem with the bill was that we were treating with the many, because, without knowing what the effect of that would be, in order to get at the few.

I would ask maybe to put some of that in perspective, if you could tell us, roughly, for the record, how many total size standards do we have in number, and the way it is right now, how many of them cause problems?

Just off the top of your head?

Mr. **Heatherly**. There are approximately 840, I believe, somewhat over 800 individual size standards, based upon SIC codes. We have some controversy or disagreement over half a dozen of them perennially. Dredging, architectural and engineering services, construction, and a couple of others.

If you change any size standard, you're going to have some controversy, but the ones we have continual criticism and problems with are those.

Mr. **Ireland**. Well, I think your point's well made. If we're going to be working in this area, we, I believe, need not cause more of a problem than we already have, and perhaps ought to focus on the problem, itself.

Let me say I'm delighted that you're here to speak on the subject of the Rule of Two. In our testimony from OMB and others, at the previous hearing, we heard that there was, in a sense, a split decision in OMB, lots of strong views on both sides and then a resolution of that matter. Nothing wrong with that; that's how the system ought to work. The decision that OMB did end up with, however, was not a popular one here, nor with the agencies that testified, and obviously not with you, as Acting Administrator.

But let me ask you, during that process that OMB made that decision, is there evidence, and I understand it was being made when you weren't on board, entirely, but is there evidence that the Small Business Administration had much of an input there? Did the Small Business Administration, either before you arrived, or after, have much of a crack at OMB?

Obviously, some of the other agencies didn't, but it did directly affect Small Business?

Mr. **Heatherly**. I am not aware of, nor have I seen, evidence that we were fully consulted during that process. I think that they are two different issues, though, Mr. Congressman. The requirement for consultation outside of OMB is one thing, and the internal process by which OMB arrives at its own legal opinion is another matter. I would not expect that we would be consulted while they were having internal discussions about what their position or their interpretation of the CICA would be.

Mr. **Ireland**. I wondered, in view of the fact of the part that I criticized pretty severely, was the fact that the OMB, on the one hand, ignored the regulatory flexibility requirements, and on the other hand, said that they'd made a judgment that it wasn't needed. Now, they are in a difficult position, as far as I'm concerned, and I think many other members of the committee—you can't have it both ways.

And I realize, as you point out, their internal decisionmaking is up to them, but, indeed, unless they are willing to listen to outside voices to get the grist for their decisionmaking, they fall into the green eyeshade category that disturbs some of us, quite strongly.

Mr. HEATHERLY. If they determine internally that they need not consult, that's their interpretation and their opinion. We are entitled to disagree with them, and our intepretation is that the Regulatory Flexibility Act does require consultation regarding the impact on small business, and no significant consultation did occur.

Mr. IRELAND. Thank you, Mr. Chairman.

Thank you, Mr. Heatherly.

Mr. MITCHELL. Thank you.

Congressman Torres, you have questions?

Mr. TORRES. No questions at this time, Mr. Chairman.

Mr. MITCHELL. Mr. Dreier.

Mr. DREIER. Thank you, very much, Mr. Chairman.

I'd like to welcome you, Mr. Heatherly, before our committee here, and tell you that contrary to what you may have heard from a lot of people here on the Hill, I think you're doing a fine job as the Acting Administrator, and pleased to see that the President's appointee, here, has come to carry out his recommendations.

I'd simply like to ask you if it's true, what we've heard, that the assault on the Rule of Two is emanating from the administration? You know, I've heard so many conflicting reports on it, and some have said that the proposal, as it's coming from the administration, is simply another assault at Small Business.

Is that the case?

Mr. HEATHERLY. I don't believe so, Mr. Congressman. I'm not aware of any coordinated or uniform approach on this. Obviously, the agencies are part of the administration, and we happen to disagree with OMB's interpretation. I think that that's indicative that the administration is divided on this issue. And certainly the administration has a strong record of support of small business, and the President is on record in support of the continuation of the Set-aside Program.

So I think it's a legal issue, here, in terms of the interpretation of CICA, and not a policy difference with regards to the desirability of small business set-asides.

Mr. DREIER. What would you like to see Congress do to try and rectify the problem?

Mr. HEATHERLY. Well, since there is a disagreement between OFPP and OMB and the agencies on this, it would certainly be helpful if Congress were to clarify once and for all, its intent with regards to the Rule of Two. We believe that CICA does not require repeal of Rule of Two. OMB has a different opinion.

If there is misinterpretation, or areas of ambiguity, Congress could clarify that by amending CICA further, or by making some other statement, that the Rule of Two is within the bounds intended by Congress.

Mr. DREIER. My colleague, Mr. Torres, has authored legislation which statutorily enacts the Rule of Two. What's your thought about that?

Mr. **Heatherly**. Well, since we believe that the Rule of Two is already incorporated within CICA, I think we would be of the opinion that it's not essential to have that because we believe that CICA already allows the continuation of Rule of Two.

However, if there is disagreement on this committee or within the Congress among committees, then it might be helpful to have that settled once and for all.

Mr. **Dreier**. Last week when Frank Swain was here, he was talking about the necessity to maintain a degree of flexibility, which a law enacting the Rule of Two here would not provide.

Were you aware he'd said that before this subcommittee?

Mr. **Heatherly**. Yes.

Mr. **Dreier**. OK. Thank you very much, Mr. Chairman.

Mr. **Mitchell**. Thank you.

I would just add, very quickly, that just a moment ago, you said that it might be good to clear up any ambiguity and so forth. That would be the role of the Congress to do that, and certainly, Congressman Torres' bill, I think, would make it abundantly clear, cleaning up all ambiguities. So, though you may not feel that it's mandatory, I think his legislation would be helpful.

Mr. **Heatherly**. In our view, the enactment of legislation would not change the way that the Procurement Program is administered at present, since we are presently administering under the Rule of Two.

Mr. **Mitchell**. But it would clear up some of the ambiguities?

Mr. **Heatherly**. It would clear up any ambiguity or disagreement over the intent of Congress regarding the Competition in Contracting Act.

Mr. **Mitchell**. Thank you, very much, Mr. Heatherly, for being with us.

Mr. **Torres**. Mr. Chairman? If I may, sir?

Mr. **Mitchell**. I'm sorry. You have a question?

Mr. **Torres**. Yes; I didn't ask the question before, because I was looking over some of the notes, here. And I was interested in Mr. Heatherly's letter to the Director of the Office of Management and Budget, Mr. Miller. You presented that in your testimony, Mr. Heatherly?

Mr. **Heatherly**. Yes.

Mr. **Torres**. And I'd like to refer to that letter, just by way of trying to understand this ambiguity we're talking about. In your second paragraph, you state in your letter that you don't believe that Joe Wright's response to Mr. Sander's letter adequately responds to the many concerns raised by a number of agencies.

And I'd like to understand what you mean, that you don't believe, included in that statement. In that letter, you state that Joe Wright's response to former Secretary Sanders does not adequately respond, as I just stated, to those concerns.

Could you elaborate on this question. I'd like to understand it a little more fully.

Mr. **Heatherly**. Well, the Joe Wright response simply restated their interpretation of CICA and did not deal with the specific concerns that were raised regarding the potential negative impact.

Mr. **Torres**. I'm sorry, which concerns were not raised?

Mr. Heatherly. Well, I'll have to refer back to Mr. Sanders' original letter.

[Pause.]

Mr. Heatherly. I think, Congressman, that all I intended by that statement was that we did not feel that Mr. Wright's response was convincing or that it adequately answered the concerns regarding both the interpretation of the CICA and the implications of administering the new standard that the agencies had expressed with regard to the very likely negative impact on the number of set-asides. Mr. Wright did not seem to be either aware of, or sufficiently sensitive to, the likely negative impact of the change in standards; specifically and especially the requirement for certification that sufficient competition would occur.

That's a new requirement that would be imposed on procurement officers which could have a chilling effect on the set-aside program. We don't think that OMB was sufficiently sensitive to the implications of that new requirement.

Mr. Torres. Thank you. I'd like to follow up by simply thanking you for being here with us today, thank you also for your staff, for your prompt attention to the letter that I sent to you on May 29, regarding Hispanic participation in the 8(a) program. I did receive your response, yesterday, and I'll be following up this letter at a later date.

But I did want to ask a quick question.

Do I still have time, Mr. Chairman?

Mr. Mitchell. Sure.

Mr. Torres. OK.

In looking over the information you provided for me, I was struck by the low percentage of Hispanic women in the 8(a) portfolio. Of the 2,828 firms in the 8(a) program, only 55 are headed by Hispanic women, which represents only 2 percent. My question to you is: Why are these numbers so low?

That's relatively a low number for the amount of women that we have out there in the field, active in business, and yet, we have this 2 percent. Is SBA actively trying to increase Hispanic women participation in the 8(a) program?

Mr. Heatherly. Yes, Mr. Congressman; we would like to increase the participation of women of all races in the 8(a) program, and in the set-aside programs, generally. To understand the dimensions of that, though, I would have to have additional data, which we'd be happy to provide and discuss with you, about the percentage of women business owners in the Hispanic business community at large.

We don't know how far off, in terms of being proportional, that the 8(a) figures are to the total universe of Hispanic firms.

Just as an aside, and not that it proves anything or indicates anything in particular, but I happened to visit last month with one of the Hispanic chambers of commerce in the State of Florida. Out of a rather large number of Hispanic business owners there was not a single woman in the room.

So, I think that the base number that we're dealing with may be fairly small, and that makes it a little more difficult, but it's something we certainly will work on.

Mr. TORRES. I understand that you're relatively new to the position; you've come to administer this agency of late, and obviously, you can't know everybody in the program, and all that is now functioning there, but I have a problem in that I receive a lot of mail, I receive a lot of calls from the people in my part of the country, the Southwest, California, to be sure, and it goes right to the nub of this problem.

In California, in Los Angeles, southern California, we have your regional administrator, in San Francisco, we have your area administrator, in Los Angeles approving programs, and I'm specifically dealing again with Hispanic women, who have signed off and said that they are viable program, that they should be certified 8(a), and yet when they get here to Washington, there are people here who reject those programs.

I have a case in point. The case of Susan Corrales Diaz, a woman, a perfect example of a woman who has taken a business and turned it around, and is making it function and work, employs people that pay revenues, taxes, provide profit, and this woman cannot get certified as an 8(a) business simply because there's a bias up here somewhere in Washington, that will not certify, in spite of the fact that the regional people have signed off on this.

Why is that?

Mr. HEATHERLY. Mr. Congressman, I'll be happy to look into that individual case, but I would reject any allegation that there is bias in our central office decisionmaking. Our 8(a) program is headed by Willie Gonzales, and I meet with him and his staff frequently, and he brings cases to me that are problem cases, or that require some direction.

I am not aware of, and would not tolerate, any bias in the decisionmaking process in the central office, or at any part of the SBA. But I will look into the specific case.

Mr. TORRES. Well, I've talked with your associate director, associate administrator on this problem, and he's tried to rectify it, but we still have people in your office here in Washington who are, in my estimation, and I'm saying this to you, now, are just simply biased against this kind of an individual.

And I don't take that kindly, especially in light of the fact that your own people on the west coast are approving the program. There's on-site visits, there are inspections, et cetera, et cetera, and I can't understand why there's a particular block on this one?

Mr. HEATHERLY. I find that hard to believe, Mr. Congressman, but I will look into it.

Mr. TORRES. You will?

Mr. HEATHERLY. Yes, sir.

Mr. TORRES. Do I have your promise?

Mr. HEATHERLY. Yes, sir.

Mr. TORRES. Thank you, sir.

Mr. Chairman, I yield back the balance of my time, if I have any.

Mr. MITCHELL. I'm not even sure you have any left.

Mr. TORRES. OK.

Mr. MITCHELL. Thank you very much for being with us, taking time from your busy schedule.

Our next witness is Mr. William G. Wallace, the Committee on Federal Procurement of Architectural Engineering Services.

Thank you, Mr. Wallace, for being here.

Mr. WALLACE. My pleasure. If I could, I'd——

Mr. MITCHELL. Sure, feel free to bring your associates up.

Would somebody check and see what this vote is.

Would you hold for just a minute? We have a recorded vote.

[Pause.]

Mr. MITCHELL. That is a vote on the Rule, and I think all of us would want to make that. We have only 15 minutes. Let's go and as many Members as possible come back as quickly as you can.

In the meanwhile, I want to thank you for a very, very full testimony which will be submitted for the record in its entirety.

Because you did make that available to us, I'd appreciate it if you'd just give the five or six major points that you want to make.

We will come back right after the vote.

[Brief recess.]

Mr. MITCHELL. I think we can resume, now. Thank you for your understanding of our problem.

Just before hearing your testimony, Congressman Berkley Bedell has a statement concerning the attempts to repeal the Rule of Two, and I ask unanimous consent that it be inserted in the record as of the moment.

[Mr. Bedell's opening statement follows:]

OPENING STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. Chairman, I would like to commend you for holding this second hearing on the Office of Management and Budget's attempts to repeal the Rule of Two standard used for small business set-asides. Your tenacity in getting to the bottom of this issue has begun to pay off.

And I do mean the bottom. Testimony and documents presented at the committee's June 5 hearing seem to expose the baser aspects of OMB rulemaking. It seems that demands by the architectural and engineering [A/E] community for the repeal of the rule of two regulation may have pressured the Office of Management and Budget to adopt a legal opinion that is contradicted by all other agencies' interpretations and that may be motivated by possible racism. Certainly, it is motivated by an utter lack of regard for its impact on small businesses. In fact, OMB seems to have violated the law by ignoring the Regulatory Flexibility Act's requirement to consult with the Small Business Administration.

OMB celebrated National Small Business Week, May 22, by proposing to repeal the Rule of Two standard used for deciding whether procurements should be set aside for small business competition. Small business representatives and all of the major purchasing agencies testified at the committee's June 5 hearing that the Rule of Two standard was vital to enabling small businesses to compete for Federal contracts through small business set-asides. They emphasized that set-aside procurements are highly competitive, evidenced by the fact that the Defense Department averages 10 small businesses bidding on a set-aside procurement, and the other agencies more.

OMB claims that its proposed rule change is required by its legal interpretation of the Competition in Contracting Act of 1984 [CICA]. At the June 5 hearing, the General Accounting Office testified that it disagreed with OMB's interpretation. The Department of Defense, the General Services Administration, the National Aeronautics and Space Administration, and the Small Business Administration all testified that they believe OMB's interpretation is wrong.

Even within OMB, there were strong views that CICA did not require the repeal of the Rule of Two. These dissenting views were overruled only after a meeting where internal memoranda state that the former general counsel of OMB made remarks indicating that his views on small business set-aside laws may have been tainted by racism and were certainly colored with disdain for all small business and the laws enacted for their protection.

OMB should be ashamed of ever proposing the repeal of the Rule of Two, and should withdraw the proposal immediately.

Mr. Chairman, today we will hear from the Acting Administrator of the SBA and from representatives of the A/E industry. I find it ironic that the first appearance of Mr. Heatherly, the Acting Administrator, before this committee finds us much in agreement when I have been directly opposed to many of his major efforts so far. Mr. Heatherly, I commend you for your strong defense of the Rule of Two. But if you really care about preserving small business set-asides, I call on you to embrace size standard reform as embodied in H.R. 1178. If we can work together to address the very real size standards problem, then we will not have to fight off attacks on the Rule of Two that are actually aimed at the size standards.

Finally, I have reviewed the prepared testimony of the A/E industry representatives. I strongly agree that we need size standard reform and that the A/E size standard should be lowered below $2.5 million. However, I am deeply disturbed that the OMB memoranda indicate that the A/E community admits launching an attack on the Rule of Two even though it has no real problem with the Rule of Two, but is rather concerned about size standards.

Further, I find the testimony insulting to the intelligence of this committee. The testimony of the Committee on Federal Procurement of Architectural/Engineering Services [COFPAES] asserts that the intent of Congress as reflected in CICA and Public Law 98-577 requires the repeal of the Rule of Two because the rule is somehow anticompetitive. As one of the members of this committee who was most active in passing P.L. 98-577, I can assure you that we did not intend to require the repeal of the Rule of Two. In fact, with section 504 of P.L. 98-577, we specifically amended CICA to affirm that competitive procedures followed for small business set-asides were included in the definition of competitive procedures and consistent with the CICA's policies on competition. To state before this committee that we intended otherwise is to insult our intelligence.

The COFPAES testimony is also misleading in that it implies that the Rule of Two results in sole source awards. This is false. As the agencies testified June 5, the fact is that small business set-aside procurements are quite competitive and usually attract a number of qualified small firms.

The COFPAES testimony asserts that threshold amounts are a better tool for making small business set-asides. In a report to Congress on exactly this subject required by P.L. 98-115, Secretary of Defence Caspar Weinberger stated that threshold amounts were an inappropriate tool for this purpose, and that the real solution was size standard reform. I attach this letter report for the record.

Finally, I am concerned that in concocting legal interpretations to defend OMB's proposed standard for small business set-asides, COFPAES has confused even itself to the extent that it is now actually working against the Brooks Act. The proposed rule would require contracting officers to set aside procurements if they determine that a sufficient number of firms can provide the service at the lowest reasonable cost. Does this mean that all A/E contracts should be set aside because there are enough small A/E firms capable of providing the services at lowest reasonable cost? I must disagree with COFPAES and affirm my continued support for making technical merit and professional qualifications the primary criteria for awarding A/E contracts.

If COFPAES objects to making cost the overriding factor in A/E procurements, why does it want to make cost the overriding factor in determining small business set-asides, which are already quite competitive? This kind of hypocritical position and misleading tactic damages credibility and undermines the understanding that we need to solve our mutual problems.

Mr. MITCHELL. Mr. Wallace, we will hear from you.

Mr. WALLACE. Thank you, Mr. Chairman.

TESTIMONY OF WILLIAM G. WALLACE, JR., CHAIRMAN, COMMITTEE ON FEDERAL PROCUREMENT OF ARCHITECTURAL/ENGINEERING SERVICES [COFPAES], ACCOMPANIED BY JOHN PALATIELLO, SECRETARY; AND PHILIP A. HUTCHINSON, COUNSEL

Mr. WALLACE. Thank you, Mr. Chairman.

I am Bill Wallace, a licensed surveyor from West Palm Beach, FL, and chairman of the Committee on Federal Procurement of Architectural/Engineering Services [COFPAES].

To my right is Phil Hutchinson. He is the counsel for COFPAES. And to my left is John Palatiello, who is the Secretary of COF-

PAES, and the director of Government Affairs for the American Congress on Surveying and Mapping [ACSM].

We appreciate the opportunity you've given us to speak to you, and to state that from our perspective, the Rule of Two is anticompetitive.

Application of the Rule of Two results in the set-aside of virtually all A/E contracts, and that's unfair to the members of our profession who are not small business. Certainly, there are some contracts that should be open to competition among all interested firms.

The set-aside method, other than the Rule of Two, has proven to be very successful in providing a fair proportion of contracts to small A/E firms, while, at the same time, increasing competition. DOD was directed by Congress to permit all qualified firms to compete for contracts over a threshold amount. This was set initially at $85,000, with the authorization to revise that amount from time to time to assure that small businesses concerned received a reasonable share of DOD A/E awards, while assuring that other firms would also have an opportunity to compete.

A review of DOD A/E contract awards data show that small business A/E firms are able to hold their own in open competition. The number of contracts received by small business firms and the value of those contracts are nearly the same under open competition as compared to the period when total set-aside was required under the Rule of Two.

In our view, there is a clear inconsistency between the directives of the Competition In Contracting Act, and other statutes which call for open competition and the Rule of Two, which restricts competition. We intend to comment favorably on OFPP's proposal to modify the Rule of Two, as part of the rulemaking process, but also would like to acknowlege, with appreciation, your interest, Mr. Chairman, and that of the committee in attempting to bring about more realistic size standards as evidenced by H.R. 1178, a bill to provide for equity in the establishment of small business set-aside size standards.

SBA's recent action to lower the A/E size standard from $7.5 million for engineering and $3.5 million for architecture and surveying to a combined standard of $2.5 million in average annual receipts, is a step in the right direction. However, even under this greatly reduced size standard, 98 percent of America's practicing architects, 95 percent of the engineers, and 99 percent of the surveyors, are considered small business.

Thus the size standard definition is not helpful in assisting truly small A/E firms in obtaining a fair share of Government business.

We have attached two documents which elaborate on some of the points we have made.

And thank you for considering our views.

[Mr. Wallace's prepared statement, with attachments, follows:]

PREPARED STATEMENT OF WILLIAM G. WALLACE, JR., CHAIRMAN, COMMITTEE ON FEDERAL PROCUREMENT OF ARCHITECTURAL/ENGINEERING SERVICES [COFPAES]

Mr. Chairman, my name is William G. Wallace, Jr. I am a licensed surveyor from West Palm Beach, Florida and Chairman of the Committee on Federal Procurement of Architectural/Engineering Services (COFPAES). The purpose of our Committee is to promote sound procurement practices for architect/engineer/surveyor (A/E) services. We appreciate this opportunity to comment on the Rule of Two.

According to SBA's current size standard, over 90% of our members are classified as small business. From our perspective, the Rule of Two is anticompetitive. Application of the Rule of Two results in the set aside of virtually all A/E contracts. This is unfair to those members of our professions who are not small business. Certainly, there are some contracts that should be open to competition among all interested firms. Because of the unique nature of A/E services and the statutory process (the Brooks Act, P.L. 92-582) which governs A/E procurement, we believe that open competition for Federal contracts will not adversely affect small firms. This is borne out by the record of DOD's A/E procurement program.

An alternative set aside method, other than the Rule of Two, has proven to be very successful in providing a fair proportion of contracts to small A/E firms while, at the same time, increasing competition. Specifically, DOD was directed by Congress in the Military Construction Authorization Act (P.L. 98-407) to permit all qualified firms to compete for contracts over a threshold amount. This was set initially at $85,000 with the authorization to revise the amount from time to time to assure that small business concerns receive a "reasonable share" of DOD A/E awards, while assuring that other firms would also have an opportunity to compete.

A review of DOD A/E contract awards data, comparing FY 1983 (the last year the Rule of Two was in effect for A/E services) with FYs 1984-85, when contracts over $85,000 were open to competition by all interested firms, is instructive.

A/E CONTRACTS
Department of Defense

	Total Contracts	Value $(000)	% Contracts to Small Business	% Dollars to Small Business
FY 83	3,994	431,473	87.0	67.6
FY 84	4,327	413,147	87.5	74.1
FY 85	4,811	456,560	81.7	66.6

SOURCE: Department of Defense

What these data show is that small business A/E firms are able to hold their own in open competition. The number of contracts received by small business firms and the value of those contracts are nearly the same under open competition as compared to the period when total set aside was required under the Rule of Two.

This result is exactly what Congress had in mind when enacting the Competition in Contracting Act (Title VII of P.L. 98-369). Congress sought to maximize competition rather than restrict competitors vis-a-vis the Rule of Two. As the House-Senate Conference Committee observed:

> "The conference substitute was 'full and open' competition as the required standard for awarding contracts in order to emphasize that all responsible sources are permitted to submit bids or proposals for a proposed procurement. The Conferees strongly believe that the procurement process should be open to all capable contractors who want to do business with the government." (Emphasis supplied.)

We wish to commend OFPP for addressing the Rule of Two issue. OFPP has a statutory obligation (P.L. 98-191) of "providing leadership ... and resolving differences ... in the development of simplified government-wide procurement regulations." In our view there is a clear inconsistency between the directives of the Competition in Contracting Act and other statutes which call for open competition and the Rule of Two which restricts competition. The OFPP is fulfilling its proper role of exercising leadership on procurement policy by resolving differences between statutory directives and the implementing regulations. We intend to comment on OFPP's proposal to modify the Rule of Two as part of the rulemaking process.

We would also like to acknowledge with appreciation your interest, Mr. Chairman, and that of this Committee in attempting to bring about more realistic size standards as evidenced by H.R. 1178, a bill to provide for equity in the establishment of small business size standards.

The architect, engineer and surveying professions have been struggling with SBA for years to promulgate size standards that are reflective of competitive conditions within the design professions. SBA's recent action to lower the A/E size standard from $7.5 million and $3.5 million to a combined standard of $2.5 million in average annual receipts is a step in the right direction. However, even under this greatly reduced size standard 98% of America's practicing architects, 95% of engineers and 99% of surveyors are considered small business. Thus, the size standard definition is not very helpful in assisting truly small A/E firms in obtaining a fair share of government business. Until the Rule of Two is modified so as to prevent the practice of virtual total set aside for A/E service contracts, there will remain very strong and vocal opposition to further size standard changes which would result in A/E firms being completely "closed out" of the Federal market.

We have attached two documents which elaborate on some of the points we have made: (1) COFPAES Comments on Rule of Two ... This is a summary of our position together with a supporting legal brief; and (2) Facts on Rule of Two ... This details problems with the Rule of Two from the A/E perspective and documents Congressional concern over the issue.

Thank you for considering our views.

ATTACHMENT 1

COFPAES COMMENTS ON RULE OF TWO

Background

- Over 30,000 firms with an average of 10 to 15 employees comprise the architect-engineer (A-E) community, including the related fields of mapping and surveying.
- The Brooks Act (40 U.S.C. § 541) provides for the careful selection of technically qualified firms to participate in competition for Federal A-E contracts.
- Since 1978 COFPAES has opposed the Rule of Two regulations which restrict competition among firms for Federal A-E contracts.

Reasons to Oppose Rule of Two

- The Rule of Two standard in the FAR, which became effective April 1, 1984, is in direct conflict with the legislative mandates of the Competition in Contracting Act (Public Law 98-369); the Defense Procurement Reform Act (Public Law 98-525) and Small Business Procurement and Competition Enhancement Act (Public Law 98-577).
- Full and open competition includes Brooks Act procurement selection procedures based on qualifications.
- The evidence in the congressional record and legislative history of procurement reform legislation in the 98th Congress leaves no doubt as to (1) its support for full and open competition even in set-aside situations and (2) rejection of the restrictive procedures embodied in the Rule of Two.
- No public policy is served by arbitrarily limiting competition to only two firms.
- The Rule of Two is anti-competitive in any industry dominated by small businesses (as defined by the SBA size standards).
- The Rule of Two provides administrative simplicity and statistical gains at the expense of full and open competition among government contractors.

Conclusions

- With the enactment of CICA and other procurement reform legislation, Congress has expressed its intent to replace the Rule of Two with a standard for competitiveness based on full and open competition.

- The legislative history of the procurement reform legislation of the 98th Congress demonstrates without a doubt Congressional distaste for the imposition of artificial barriers on the competitive process. Under these circumstances no arbitrary rule based on the existence of two, four or ten contractors will provide an acceptable means of demonstrating that a "fair" proportion of contracts is being channeled into the small business community.

- The establishment of a cap or dollar threshold above which all responsible firms may compete and below which all responsible small firms may compete provides an agency with an administrative tool to modify competitive procedures so that all small businesses have a real opportunity to compete for a fair proportion of agency contracts.

COMMENTS ON FAR 19.502
SMALL BUSINESS SET-ASIDE REGULATIONS

Background

In an October 12, 1984, Notice in the Federal Register (Notice) the Office of Federal Procurement Policy (OFPP) asked for comments on certain small business set-aside regulations. 49 Fed. Reg. 40135 (1984). The Notice suggest that the principal criticism of these regulations, popularly referred to as the "Rule of Two" is that there has been inadequate public notice and availability for comment prior to promulgation of the final regulations in the Federal Acquisition Regulation (FAR).

The Notice fails to recognize, however, that the "Rule of Two" was a controversial and contested regulation, as a matter of procurement policy from the time of its initial use within the Defense Department (DOD), contrary to claims from agency personnel about its workability contained in the Notice. For example, representatives of Defense Department agencies with frequent needs to acquire architect-engineer (A-E) services (including mapping and surveying services) privately express their frustration at the counterproductive impact of the "Rule of Two" on the ability of an agency to ensure quality assurance through the Brooks Act selection procedures (40 U.S.C. §§ 541 et seq.). Such complaints are rarely heard by the public or in official comments, however, because of the DOD philosophy that set-aside policies are to be used to meet small business goals for the total amount of procurements in all industries, requiring those industries with large numbers of small businesses, such as the A-E community, to bear a disproportionate burden in meeting agency-wide goals. Now that the FAR has applied the "Rule of Two" to the civilian agencies as well, problems similar to those expressed by DOD personnel have arisen in the Veterans Administration and the General Services Administration.

Further indications of the controversy arise out of the National Aeronautical and Space Administration (NASA) situation. NASA did not employ the "Rule of Two" until the summer of 1983 when it published a notice in the Federal Register without benefit of public comment. See 48 Fed. Reg. 32797, 32800 (July 19, 1983) Coincidentally, publication of the NASA "Rule of Two" in the Federal Register in July 1983 occurred just prior to publication of the FAR, following the agencies' "Executive Review" in September 1983. The reference in the Register to the "changed polic[y]" which generated the "Rule of Two" has no statutory basis, and is instead, a product of creative rulemaking. Indeed, the OFPP Notice itself recognizes that the proposed adherence to the "Rule of Two" is basically for administrative convenience and not to meet any expressed statutory requirement. 49 Fed. Reg.

40135 (October 12, 1984).

The "Rule of Two" language in FAR Section 19.502 spells out the requirements for setting aside acquisitions for small businesses. In pertinent part the FAR states:

> 19.502 Setting aside acquisitions.
>
> 19.502-1 Requirements for setting aside acquisitions.
>
> Using the order of precedence in 19.504, the contracting officer shall set aside an individual acquisition or class of acquisitions when it is determined to be in the interest of (a) maintaining or mobilizing the Nation's full productive capacity, (b) war or national defense programs, or (c) assuring that a fair proportion of Government contracts is placed with small business concerns, and when the circumstances described in 19.502-2 or 19.502-3(a) exist.
>
> 19.502-2 Total set-asides.
>
> The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business--small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but *see* 19.502-3 as to partial set-aside). Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable

> expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

FAR 19.502-2 entitled "Total Set-Asides," is an automatic, total set-aside for certain classes of procurements where there will nearly always be at least two "small" firms (within the size standards established by the Small Business Administration (SBA)) which meet the triggering criteria. This will obviously be true in industries with a large concentration of small businesses.

In the architect - engineer profession, for example, there are over 30,000 architect-engineer firms in the United States and the average size firm employs 10-12 people. However, based on definitions of small businesses promulgated by SBA, an architect-engineer firm with 200 employees is considered "a small business." In fact, over 99% of the total firms qualify as "small businesses" with less than 200 employees. Among those firms practicing surveying, none exist that are not within the current size standard.

As a consequence, the truly small, local firms -- those closer to the industry size average -- have little opportunity to compete successfully for design procurements under the "Rule of

Two." The impact of the "Rule of Two" is to virtually eliminate approximately 250 larger design firms from competition for design contracts under the FAR and create an environment which favors firms at the upper end of the spectrum at the expense of the smallest firms. Despite OFPP's contention in the Notice that the "Rule of Two" be considered in the abstract, its relationship to small business size standards and its impact on the eligibility for consideration for contracts cannot be ignored.

The "Rule of Two" is convenient for government officials but does not assist small businesses. The regulation is lethal to key industries, dominated by smaller businesses, which provide essential goods and services to the Federal Government. This artificial measure of competition produces statistical achievements in the name of small business but denies successful companies -- both large and truly small -- the opportunity to compete for government contracts. It works against the interest of entry level -- truly small, minority and women-owned -- firms in industries with heavy concentrations of small businesses. Elimination of the Rule of Two will not, and should not, guarantee award to any contractor list should provide the opportunity for all technically qualified firms to complete.

The "Rule of Two" also makes some contracting officers and small business representatives look good on paper in a few areas but provides no incentive for them to advocate competition for small businesses in other financially fertile areas, e.g. major weapons systems, electronic and computer systems, etc. Some emerging growth oriented companies have stiffled their natural expansion to stay within the protected preference market for small businesses. This is not a healthy development for competition in the marketplace.

The October 12 Notice suggests that the FAR 19.502 language is the exclusive measure of the standard of competitiveness required to set-aside a procurement for small business. It further directs persons responding to the Notice to focus on the Small Business Act (15 U.S.C. § 630 et seq.) as the sole authority for analyzing what is the most appropriate standard for determining competitiveness.

The Notice fails to acknowledge or consider the legal impact of the relevant legislative mandates provided by the 98th Congress. It also fails to recognize the need for action by OFPP to resolve the inconsistency between regulations guiding procurement of A-E services by the military agencies, on the one hand, and by the civilian agencies, on the other hand. When the recent actions of the House and Senate on procurement reform matters, detailed below, are analyzed, they provide conclusive evidence that Congress intended to establish "full and open competition" as the standard for competitiveness on a uniform basis in all Federal procurements (both military and civilian), including those in the small business set-aside arena. Moreover, with particular regard to the procurement of architect-engineer services, it is clear that Congress intended to focus the revised standard of competitiveness on the traditional quality assurance selection procedures embodied in the Brooks Act, 40 U.S.C. § 541 and 10 U.S.C. § 2855.

DISCUSSION

FAR Standard Modified by Competition in Contracting Act

The 98th Congress passed several major procurement reform measures (addressing matters such as small business set-asides and procurement of A-E services) which modified the standard for competitiveness in the Federal procurement system. In 1984, the Senate and House agreed to the conference report on the Deficit Reduction Act which included in Title VII, the Competition in Contracting Act (Public Law 98-369) 98 Stat. 494 (CICA). When signed by the President on July 18, 1984, CICA marked the culmination of years of legislative work to modify Federal procurement procedures and to enhance competition within the system. *See* H.R. Rept. No. 98-861, 98th Cong. 2d Sess. 1422. In particular, the CICA addressed the issue of measuring the standard of competitiveness required for Federal procurements and changed the baseline measure for all executive agencies, both military and civilian.

See Sections 2711 and 2731, *supra*. In Section 2732 the statutory language of CICA provides as follows:

> (b)(1) ...
>
> (2) Section 16(1) of [the OFPP] Act (41 U.S.C. 414(1)) is amended to read as follows:
>
> "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".
>
> [Emphasis added.]

It is clear that this language amends the OFPP Act to require the use of full and open competition in procurement of goods and services by the executive agencies. The explanatory statement of the Managers confirms that the language in the CICA requires the agencies, when using competitive procedures,

> . . . to establish policies, procedures and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs. *Id*. at 1434. [Emphasis added.]

Reading the statutory language of the CICA, together with the legislative history in the Statement of Managers in the Conference

Report, the intent of Congress is clear. The Congress intended to redefine the requirements for competitiveness to permit greater flexibility for the contracting officer to maximize opportunities for competition in meeting the needs of the government.

In particular, the reference of the "sufficient number" test recognizes the need for the contracting officer to have flexibility to utilize his or her judgment as to what level of participation is adequate to assure competitive acquisition of particular goods or services in the absence of other statutory guidance. Id. Prior to adoption of the FAR, the civilian agencies used a "sufficient number" standard to measure the adequacy of the number of contractor proposals submitted to assure that a fair proportion of contracts would be awarded to small businesses in any particular industry. 41 C.F.R. § 1-706.5 This standard was not intended as an absolute barometer but as a means of establishing that a fair proportion of contracts would be available for competition among small business in the absence of other statutory guidance. 41 C.F.R. § 1-706.5(e).

But, in the case of architect-engineer services, statutory guidance was provided in the Brooks Act to measure the sufficiency of the number of proposals submitted to assure adequate competition and award of a fair proportion of A-E services contracts to small businesses. This analysis is reinforced by subsequent legislative developments, discussed below, which address directly the standard for competitiveness in the acquisition of AE services by both the military and civilian agencies.

In establishing competitive requirements, the CICA is characterized appropriately as a remedial statute. It aims at correcting procedural problems in the procurement process. Long-accepted principles of statutory construction hold that remedial statutes such as the procurement reform provisions of the CICA are subject to liberal construction. See 2A Sands, Sutherland Statutory Construction § 60.02 (1973). In order to safeguard the interest of the American public in competitive procurements, even in the context of set-asides, regulations which purport to set requirements for competition must then reflect the "full and open" competition requirements set out in Section 2732 of the CICA.

Moreover, the CICA also clarifies the applicability of the procurement reforms to the acquisition of A-E services under the Brooks Act, 40 U.S.C. § 541 and 10 U.S.C. § 2855. The CICA notes that competitive procedures mean "full and open competition . . . includ[ing] . . . procurement of architectural or engineering services conducted in accordance with Title IX of the Federal Property and Administrative Services Act of 1949 (40 U.S.C. § 541 et seq.)". This language removes any doubt that the traditional quality assurance selection procedures for A-E services is anything less than a fully competitive procedure.

Given this analysis, it is unreasonable and inappropriate to restrict the measure of competitiveness for A-E contracts simply to an arbitrary number of proposals, i.e., two, ten or any absolute number, especially in the face of other statutory guidance or industry profiles to the contrary. It is inconsistent with the plain meaning of the CICA and related procurement reform legislation to permit FAR 19.502-2 to remain in its present form. When the statutory language is clear -- as is true with the CICA, traditional precedents confirm that the language of CICA is conclusive and overrides inconsistent regulatory provisions. See United States v. Clark, 454 U.S. 555 (1982).

FAR "Rule of Two" Standard is Anti-competitive

Contrary to the claims made in the Notice, the "Rule of Two" is anti-competitive for architect-engineers and other contractor communities having large numbers of small firms. Instead of promoting competition, it constitutes an automatic triggering mechanism for a virtual "sole source" (just two firms) procurement instead of promoting "full and open competition" by accepting bids and proposals from all interested, technically qualified parties. The Committee on Federal Procurement of Architectural and Engineering Services (COFPAES) and various individual professional societies and associations representing architects, engineers, surveyors and related specialists, have taken the position that their professions are sufficiently competitive that they neither need nor require set-asides nor specialized size standards to spread opportunities equitably for Federal procurement contracts among firms within the industry.

The Competitiveness Requirements which Guide the Set-Aside Decision Are Not Governed Only by the Small Business Act but also by Related Legislation.

OFPP is mistaken when it contends that (1) a "fair proportion" requirement refers only to the total number of procurements for small businesses in all industries rather than within specific industries; and (2) the Small Business Act (15 U.S.C § 631 *et seq*.) is the only legislative authority with respect to set-asides.

While it may arguably have been true prior to 1983 that the Small Business Act was the only relevant legislation to guide the set-aside decision, Congress has spoken authoritatively and repeatedly during the 98th Congress in these areas, previously dealt with only indirectly by the courts and the Federal agencies. In addition to the CICA, the Military Construction Authorization Act of 1985 (Public Law 98-407) Congress imposed a statutory requirement for full and open competition in all A-E contracts over $85,000. The Secretary of Defense was given authority to revise the threshold amount to ensure that small business concerns received a "reasonable share" of contracts.

In further explanation of the term "reasonable share," the report from the Senate Armed Services Committee recognized that the Secretary should have discretion to measure a "reasonable share" based on data from the Federal Procurement Data Center (FDPC). A parallel responsibility requires the Secretary to assure continued participation of larger firms in DOD contracts in support of mobilization efforts. This objective is also frustrated when the "Rule of Two" triggers class set-asides to block opportunities for larger businesses to compete for DOD contracts. S. Rep. 98-500, 98th Cong. 2d Sess. 357 (1984). The report further admonished the Defense Department not to utilize open-ended design contracts to avoid this provision instead of breaking out smaller, definitize contracts which would by definition increase opportunities for truly small firms to compete. Id. The provisions of the Department of Defense Appropriations Act of 1984 (Public Law 98-212), 97 Stat. 1455, had included a similar provision which established an $85,000.00 threshold.

The Congress acted also to enhance competition among small businesses in the Small Business and Federal Procurement Competition Enhancement Act, Public Law 98-577. The floor statement by Congressman Brooks in support of that legislation illustrates consistent Congressional direction in favor of increasing competition. See Cong. Rec. H10842 (October 2, 1984). Indeed Mr. Brooks characterized the bill as a "companion bill" to the CICA and noted that it would

> strengthen full and open competition ... [and] remove many of the barriers to competition which have frustrated the efforts of many businesses, to enter the Federal marketplace. Id.

The Small Business and Federal Procurement Competition Enhancement Act (Public Law 98-577) also amended the CICA to provide greater flexibility in the decision to use set-aside procedures. Section 504 revises the language of Section 303(b)(1) and (2) of CICA to state that the contracting officer "may exclude" all but small businesses but only if it is demonstrated that the set-aside permits all "responsible" firms to bid and further the interest of obtaining a "fair proportion" of federal contracts. The use of the permissive language "may" is a change from the mandatory "shall" language in the original CICA consistent with requiring greater agency justification prior to imposing any restraint on the "full and open competition" standard. In the context of the legislative history of both bills, it follows logically that Congress intended to require the contracting officer to make an evidentiary showing of the need to use the anti-competitive restraint of the set-aside procedure to obtain a fair proportion of small business awards prior to utilization of such a mechanism.

Moreover, five key House Committee Chairmen blocked efforts to consider H.R. 2133, legislation reported from the Small Business Committee which attempted to put the "Rule of Two" into permanent statutory law. See Cong. Rec. H 3773-74 (May 10, 1984). The House also rejected efforts by Congressman Bedell to amend the Defense Authorization legislation (Public Law 98-525) with language which would have prohibited the use of "caps," or dollar thresholds, to control the restrictiveness of set-asides and to override the "Rule of Two" in order to make available a fair proportion of contracts to small businesses. See Cong. Rec. H5099 (May 31, 1984). These legislative facts reflect a consistent trend of support for competitive procurement procedures. In sum, a clear Congressional mandate emerges from these actions which supports full and open competition as the appropriate standard for competitiveness and for establishing an opportunity for award of a fair proportion of contracts for small businesses and rejects unequivocally the "Rule of Two."

Alternatives to the "Rule of Two"

A replacement for the "Rule of Two" is the standard of "full and open" competition, as required by the recently enacted CICA. Under that new standard, all contractors who wish to submit bids or proposals are entitled to make such submissions. The Brooks Act, as codified in 10 U.S.C. § 2855 and 40 U.S.C. § 541, provides a mechanism for full and open competition in the procurement of architect-engineer services consistent with the standard articulated in the CICA and is the specific appropriate standard for procurement of architect-engineer services under a small business set-aside. All companies would be able to submit proposals and be selected based on qualifications. Such a standard would permit contracting officers to match the size, qualifications and geographic distribution of firms with the requirements of the Federal agencies.

The Advocate for Competition, created by Amendments to the OFPP Act found in Section 2732 of the CICA, can also play an important role in reviewing the appropriateness of imposing any artifical barrier to full and open competition in order to obtain a "fair proportion" of contracts for small businesses. The Congress intended for the Advocate to challenge barriers to competition not to impose them. Development of explicit internal guidance on criteria using set-asides would fit within the responsibilities of the Advocate.

The full and open competition standard provides a more realistic opportunity for truly small A-E firms to receive a reasonable proportion of federal design contracts without precluding any segment of the A-E community from federal design work. The establishment of a dollar threshold for total set-aside of design contracts, as described above, is one reasonable alternative to the total class set-aside. It provides for a partial set-aside. Consistent with the statutory provisions now applicable to DOD, the authority of the agency head to revise the amount of the threshold represents one way to ensure that small businesses receive a "reasonable share" of contracts. Alternatively, OFPP might be asked to assume a threshold monitoring function to permit the flexibility necessary to make this alternative administratively feasible on an industry-wide basis.

Conclusion

Failure to take corrective action and recognize the Congressional mandate for change of FAR § 19.502-2 would be irresponsible and unwise. OFPP must act promptly to resolve the differences among the agencies as a result of the FAR set-aside regulation and the conflicting statutory directives of the 98th Congress outlined above. At a minimum, OFPP must also resolve the clash between Defense agencies which are now guided by the provisions of Public Law 98-407 as implemented by the DOD Supplemental Regulations and civilian agencies which are still required to follow the restrictive provisions of FAR 19.502. The mandatory language of FAR 19.502 and the permissive language of Public Law 98-597 cannot continue to exist in conflict.

Under the OFPP Act Amendments of 1983, OFPP is authorized "to prescribe Government-wide regulations, procedures and forms in a timely manner when the three regulation writing agencies (DOD, NASA and GSA) are unable to agree. 41 U.S.C. § 405(c) Faced with the existing conflict between the FAR regulations guiding the civilian agencies and the statutory cap applicable to the military agencies, OFPP must step into the dispute. The procurement reforms of the 98th Congress demand that OFPP resolve the conflict among the agencies by the establishment of a consistent, Government-wide regulation that supports "full and open competition with a fair proportion of contracts awarded to small business. OFPP has express authority from the Congress to Act to resolve such conflicts and to rescind an inconsistent government-wide regulation. 41 U.S.C. § 405 (g). OFPP should utilize its authority to assure uniform procurement procedures. See S. Rep. 98-214, 98th Cong. 1st Sess. 15 (1983).

COFPAES would be pleased to meet to discuss the several recommendations herein and any other reasonable alternating suggested to the current Rule of Two.

ATTACHMENT 2

IMPACT OF THE "RULE OF TWO" ON COMPETITION

The Office of Federal Procurement Policy (OFPP) recently issued a proposed rule requiring a change in procurement regulations to implement provisions of the Competition in Contracting Act of 1984. This proposal, now pending, was necessitated by the fact that under current law, leading Architect-Engineering (A-E) firms, surveyors, construction companies, and businesses in several other industries are largely precluded from competing for Federal government contracts by Part 19.502.2 of the Federal Acquisition Regulations (FAR). That requirement was inserted into the FAR without benefit of public comment during the executive review which preceded its publication as a final rule in September 1983. The provision mandates "Total Set-Asides"--"The entire amount of an individual acquisition or class of acquisitions, including contracts for Architect-Engineer services, research, development, test and evaluation, maintenance, repair, and construction except small business-small purchase set-asides shall be set aside... ."

Employing the controversial "rule of two", it requires that whenever a contracting officer believes there are two or more small businesses available to fulfill a contract at a reasonable price, the entire class of contracts must be set aside for small business. The "rule of two", unless constrained by the OFPP proposal or legislated thresholds such as the $85,000 threshold for Military Construction, in combination with unrealistic size standards, imposes a virtual ban on competition for Federal government work for so-called "large" companies.

An example is the 30,000+ firm A-E industry, where the average company employs 12 people and has gross annual revenues of between $500,000 and $1 million. The SBA size standard classifies companies with approximately 150± employees and $7.5 million in gross annual revenue as "small". While SBA has recently announced a size standard change, the net effect will be about the same (see note at end). Thus, truly small firms--including almost all minority- and women-owned firms--must compete with companies many times their size, all within the category of "small" businesses. These truly small firms must compete at a disadvantage with virtually the entire industry for set-asides and other assistance instead of against their fellow "small businesses". The size standard also disqualifies about 300 "large" companies. While these excluded firms provide about 45 percent of employment in the industry, are industry leaders, and possess considerable expertise in all phases of engineering, they were excluded in the name of so-called "small business" programs which badly miss the mark.

CHRONOLOGY OF EFFORTS TO PROMOTE COMPETITION BY CHANGING THE "RULE OF TWO"

o The "rule of two" was first used by the Department of Defense in its Defense Acquisition Regulations (DAR) to set-aside whole classes of procurements late in the 1970s. While DOD cited 1978 amendments to the Small Business Act for doing so, Civilian

Agencies, interpreting the same Act, did not find themselves required to include it in the Federal Procurement Regulations.

- The Committee on Federal Procurement of Architectural-Engineering Services (COFPAES), which represents major A-E societies, the Design Professionals Coalition, organizations representing the construction, dredging, and clothing apparel industries, and individual firms have been very active in raising questions about the "rule of two" and application of Small Business Programs since then.

- Starting in 1981, constituent inquiries by Senators and Congressmen were first answered by DOD with claims that there was "no problem", "Congress made us do it", and misleading statistics purporting to show that large A-E firms were obtaining most of the work. Only after repeated efforts by numerous Senators and Congressmen did Secretary of Defense Weinberger acknowledge that there was a problem; corrected data showed "large" A-E firms were getting less than 20 percent of the contracts.

- COFPAES filed a formal DAR case with DOD requesting a change in the "rule of two" through modification of the Defense Acquisition Regulations (DAR) in November 1982. The DAR Council refused to take up the matter, claiming imminent implementation of the earlier-mentioned Federal Acquisition Regulations (FAR) precluded action.

- Testimony was submitted to the Senate Small Business Committee on this matter during 1981 hearings. COFPAES and other industry witnesses testified before the Senate Armed Services Committee in 1982 and 1983.

- The Senate Armed Services Committee, supported by its House counterpart, concluded that there were inequities in A-E procurement opportunities. Report language, requiring DOD to modify its policies to ensure adequate contracting opportunities to truly small and large A-E firms, accompanied the FY 1983 Military Construction Authorization. DOD ignored the Report language and was almost two months late with a required January 1, 1983 report that was judged unsatisfactory and misleading by the Committee.

- The A-E community, which has tried repeatedly for administrative relief, engaged in lengthy negotiations with DOD's Office of Small and Disadvantaged Business during the Spring of 1983. These negotiations produced an approach whereby all A-E Military Construction contracts of $85,000 or more would be open to competition by firms of all sizes under a "DAR deviation". This agreement was to have been announced in DOD's testimony before the Senate Armed Services Committee in April 1983. The DOD witnesses instead professed little or no knowledge of the problems and none of the agreement. They heatedly disclaimed that DOD had any responsibility for resolving this policy question.

- Chairman Thurmond and an angry Armed Services Committee then included the $85,000 threshold for open competition for A-E

Military Construction contracts in the FY 1984 Authorization and accompanied it with strong supporting language in Senate Report No. 98-174.

- The Senate Appropriations Committee, also aware and concerned, included language in Senate Report No. 98-180 (accompanying the FY 1984 Military Construction Appropriation) strongly supporting the Armed Services Committee's conclusions and actions.

- Faced with the prospects of permanent Congressional legislation on the matter, DOD agreed to the $85,000 open competition approach and published a "DAR deviation" in a June 24, 1983 Memorandum issued by James Brannan, Director of the DAR Council.

- An even stronger July 13, 1983 Memorandum was issued by Mary Ann Gilleece, Deputy Under Secretary of Defense, when the Naval Facilities Command (NAVFAC) refused to accept the policy change and on July 11th issued a contrary directive to its personnel.

- Just before Congress adjourned in August 1983, DOD officials persuaded Chairman Thurmond to remove the $85,000 threshold requirements from the Military Construction Authorization on the Senate floor, claiming that it was no longer necessary to legislate since the administrative remedy would accomplish the same objective.

- Within days after Congress adjourned for its August recess, the $85,000 threshold policy was discarded.

- On September 19, 1983, the Federal Acquisition Regulation (FAR) was included in the Federal Register during executive review without benefit of public comment. The FAR requires the total set-aside of all contracts for A-Es and several other classes of procurements for using the "rule of two". Most commentors on an earlier draft of the FAR opposed inclusion of the "rule of two".

- Angered by the inclusion of the "rule of two" into the FAR, Congress included language in the Defense Appropriation for FY 1984 (P.L. 98-212), which stipulated that all DOD A-E projects with fees greater than $85,000 must be open for competition by firms of all sizes. This was done over the objections of DOD's Office of Small and Disadvantaged Business, the very agency which, as noted earlier, proposed it.

- The Navy rushed more than 100 A-E contracts out the door between the threshold's becoming law and DOD's publishing the implementing regulations. Some were subsequently readvertised.

- Despite P.L. 98-212's specifically naming the Department of Defense and its component services and not tying the language to funds appropriated by it, DOD's implementing regulations astonishingly provided that the open competition requirement did not apply to the Corps of Engineers Civil Works Functions.

- The House Small Business Committee reported a massive rewrite of Federal Procurement Law under the guise of "spare parts" reform in 1984. H.R. 2133, which proposed to write the "rule of two" into law, was opposed by the Administration. It was finally withdrawn from the House calendar when a broadly based construction/A-E/business/industry/labor/university coalition led by five Committee Chairmen and their Ranking Minority Members opposed it. Their efforts were supported by the Speaker of the House and numerous other Chairmen/Subcommittee Chairmen/Ranking Minority Members whose substantive programs would have been harmed.

- The House defeated an amendment offered by Rep. Berkley Bedell to H.R. 5167, the Defense Authorization for FY 1985, which would have prohibited use of "open competition" thresholds.

- Representatives of the Design Professionals Coalition, COFPAES, and other industry representatives met with the Administrator of OFPP and his staff several times during 1984 to press for administrative relief. In April 1984, ten organizations representing affected industries petitioned OMB Director David Stockman, the Defense Acquisition Regulations Council, and the Civilian Agency Acquisition Council requesting elimination of the "rule of two". The American Bar Association on August 13, 1984 directed a similar letter to both Councils.

- Acting on the initiative of the Senate Armed Services Committee, Congress made the "open competition" thresholds for DOD A-E contracts permanent in P.L. 98-407. An $85,000 threshold was required for FY 1985; the Secretary was given authority to adjust it on an annual basis, beginning with FY 1986.

- OFPP requested comments on the "rule of two" in the October 12, 1984 Federal Register; the comment period was extended to December 31, 1984. There were overwhelming numbers of comments by affected industries and associations representing them in favor of eliminating the "rule of two".

- Congress created a requirement for "full and open competition" in the Competition in Contracting Act (P.L. 98-369) and reinforced it by the Small Business and Federal Procurement Competition Enhancement Act (P.L. 98-577) and Defense Procurement Reform Act (P.L. 98-525).

- Rep. Berkley Bedell announced his intention to offer an amendment to H.R. 1872, the FY 1986 DOD Authorization, to prevent use of "open competition" thresholds to limit set-asides. The amendment was subsequently withdrawn in the face of overwhelming opposition.

- Rep. Bedell declared that he would offer an amendment to prohibit limitations on set-asides to H.R. 1409, the FY 1986 Military Construction Authorization. Due to overwhelming opposition, this amendment was also never offered.

- The head of the Office of Federal Procurement Policy, operating under authority granted by the OFPP Act as amended, directed DOD, NASA, and GSA in a February 21, 1986 Memorandum to publish a replacement for the "rule of two" standard within 30 days. This revision would bring the FAR into conformity with the Competition in Contracting Act of 1984's requirement for "full and open competition" by substituting a "sufficient number" small business set-aside triggering mechanism for the "rule of two". The three Agencies declined to act, suggesting that OFPP itself use its own authority to make the change.

- At the urging of numerous Senators and Congressmen, including the authors of the Competition in Contracting Act -- House Government operations Committee Chairman Jack Brooks and Ranking Minority Member Frank Horton, and Chairman William Cohen and Ranking Minority Member Carl Levin of the Senate Government Affairs Subcommittee on Oversight of Government Management -- OFPP exercised its authority and published the document on its own in the May 22, 1986 Federal Register with a 60-day comment period which ends July 21, 1986.

Note: After six years of effort, SBA on June 9, 1986 announced a reduction in the size standard for Engineering, Architectural, and Surveying Services to $2.5 million, rather than $1.5 million as SBA had proposed or the $1 million size standard recommended by the A-E community. The effective date is August 8, 1986. Under the $2.5 million standard, SBA reports that 95% of engineering firms, 97% of architectural firms, and 99% of surveying firms will still be defined as "small business".

6/12/86

Mr. Mitchell. Thank you very much, and welcome to you, too, gentlemen.

Let me say at the outset, before we start questions, that I have been acutely aware of this problem, the problem of architects and engineers. A particular group, the Black Architects and Engineers, have been coming to me, regularly, and I share your frustration, in that we can't get this off the dime.

I wanted to let you know that that's my position.

Now, the American Consulting Engineering Council is a member of your umbrella organization, is it not?

Mr. Wallace. That's correct.

Mr. Mitchell. OK. And it certainly has been very active, very vocal, in its efforts to repeal the Rule of Two. Now, let me give you all the facts on this.

At our request, two weeks ago, we were provided an internal memoranda from the Office of Management and Budget. One of those memos, dated April 18, is from William Mathis, the Acting Administrator of OFPP, to Joseph Wright. The memo relates the contents of a meeting that took place between the OFPP and Mr. Bill Birkhofer, Associate Director of ACEC. I just want to quote one paragraph from that memo, and then I'm going to have the memo submitted for the record.

Quoting:

> Birkhofer admitted to us, quite candidly, but not for general dissemination, that the Rule of Two was not his problem, but that he had used it to get the Government's attention. His problem, he frankly stated, is SBA's unreasonably high size standards and his frustration, since 1981, in getting the standard lowered.

[A copy of the referenced memo follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

APR 18 1985

MEMORANDUM THRU: ARLENE TRIPLETT

TO: JOSEPH WRIGHT

Bill

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two

After our meeting last Friday I moved to implement your suggestions on amending FAR 19.505-2, Total Set-Asides Provision (TSAP) re the "Rule of At Least Two."

First, Owen Birnbaum and I met with a staff member of the Senate Small Business Committee authorized to speak for Bob Dotchin, the Staff Director. The representative, Bill Montalto, was receptive to our suggestions that: (1) A&E procurements be tiered to "marry" the size of competing A&E firms with the size of the procurement (see our memo to you of April 3, 1985); (2) Prevent excessive subcontracting by small firms receiving awards under small business set-asides; (3) Carefully examine the anomaly of awards to a small or minority company in an amount greater than its size standard. He was also impressed with our plans to revise the FAR, discussed in detail below, to stress more selective set-aside procedures.

Second, we met with Bill Birkhofer, Associate Director, of the American Consulting Engineers Council (ACEC). He, also, was receptive to the proposals set forth in the preceding paragraph. We discussed with Birkhofer the TSAP ("Rule of at Least Two") in great detail. We agreed in principle, and even in some detail, on an amendment to the TSAP (FAR 19.502.2) to caution contracting officers that they: (1) should not apply the set-aside procedures mechanically or unthinkingly; (2) should consider the Government's need for high-quality items, particularly in high-tech areas; and (3) must follow the CICA requirement for receipt of a "sufficient number" of bids from responsible sources to fulfill the Government's requirements at the lowest reasonable cost.

Birkhofer admitted to us, quite candidly but not for general dissemination, that the "Rule of at Least Two" was not his problem but that he used it to "get the Government's attention." His problem, frankly stated, is SBA's unreasonably high size standard and his frustration since 1981 in getting the standard lowered. In my opinion, the standard of $7.5 million of sales averaged over a three year period is too high and should probably be set at $2,000,000. I will be pleased to demonstrate the basis for that judgment.

I am not happy at the slow pace at which SBA is moving on the matters we discussed with Frank Swain, Don Young, et.al. almost a month ago. I prefer to move in concert with them but am prepared to proceed without them, if necessary.

Mr. Mitchell. And I share his frustration. Even though the memo is a part of the June 5 record, I again, want to submit it for the record, this morning. I've been in the same position, where I want to get something done and I can't get action. Therefore, I make another attack in another direction.

That's the background.

If the size standard were lowered to say, $1 million, would that take care of your objection to the Rule of Two?

Mr. Wallace. Not as I see it in the A/E community. Even if it was lowered to $50,000, you would still have a problem. The point that we're coming across with is the fact that the Rule of Two is anticompetitive. We would like to see A/E procurement totally open.

Mr. Mitchell. Let me ask you another question.

To the best of your knowledge, did the architectural engineering community ever agree to, quote, "back away from" the Rule of Two, in return for a lower size standard or maximum dollar cap?

Mr. Wallace. I have never heard any discussion about that, in private practice, nor with COFPAES.

Mr. Mitchell. Now, I'm interested in the procedures by which you arrive at a position. Did you ever poll your members by size to determine their position on size standards, or the Rule of Two?

Mr. Wallace. Not by size, but by members. There are six organizations that comprise COFPAES, covering practically the entire design professional field.

And we have a unanimity vote that's absolutely necessary. If one of the societies disagrees, then we will not take a stand. And every stand that we've taken has been approved by all of the organizations therein.

Mr. Mitchell. OK, but that's not quite the same as I'm talking about. This is approval by all the organizations.

The point is that there's a difference in opinion between large A&E's and smaller ones. And I—remember, I'm on your side—I agree with you that size standards ought to be changed, but I would suspect that a poll of your individual members, based on size, might give you a slightly different result.

Mr. Palatiello. Mr. Chairman, may I help answer that question?

Mr. Mitchell. Yes.

Mr. Palatiello. On the question of a lower size standard, we knew that would be controversial. We made a specific point of going back to each of the six-member societies that make up COFPAES, and asked them to go through their own internal democratic processes, and bring it up through their boards of direction, and have a vote, as to whether the organizations were in favor of a lower size standard.

And each organization came back with an agreement in favor of lower size standards.

Now, I have to be honest and say we have not done precisely that process and precisely polled them on the question of a Rule of Two.

Mr. Mitchell. That's the issue.

Mr. Palatiello. But let me point out that, as you know, we, too, work as a representative democracy, so to speak, and that each organization, through its own process, selects someone to represent the interests of their organization and their members or member firms, and to articulate that policy at the level of COFPAES as an umbrella organization.

Mr. MITCHELL. Thank you. I understand, but we're dealing only with the Rule of Two, this morning. And I wanted to make sure. I think I'm right. I think if every individual member were polled on a size basis, you might get a slightly different interpretation.

Your testimony is excellent. It's unusual, for me to take written testimony from experts and try to clarify or change it, but there are a number of misstatements in your prepared testimony, and I'm absolutely constrained to comment on them, and you need not respond.

In attachment 1, in your testimony, you say that the Rule of Two is, "in direct conflict, not only with CICA, but also with the Defense Procurement Reform Act, and also with the Small Business Procurement and Competition Enhancement Act."

Now, that's a law that I authored; that's my law. And not even OMB would make such an extreme statement. I just want to note, for the record, don't do that, please. Don't take a piece of legislation that I crafted and authored, and say that it's in direct conflict with the Rule of Two. It is not.

We scrupulously crafted that legislation, making sure that it did not impact negatively on the Rule of Two. And that's a misstatement that I just had to clear up for the record.

Mr. WALLACE. I'll fire the counsel, just as soon as we get through here.

Mr. MITCHELL. No, don't fire him. Please don't fire him. Hang him by his thumbs.

Mr. WALLACE. OK.

Mr. MITCHELL. Now, in the same attachment, you say that the congressional record on procurement reform legislation enacted during the 98th Congress, leaves no doubt as to, and I'm quoting from your attachment, "leaves no doubt as to rejection of the restricted procedures embodied in the Rule of Two."

Once, again, I want the record to reflect what is really accurate information. It is my complete understanding that nowhere during the floor debate on these three acts, did any Member ever mention the Rule of Two test of competition for small business set-asides. That never came up in the floor debates nor in the committee debates. So that's a slight error that I think you would want to correct. OK.

Finally, I want the record to be absolutely clear. In attachment 1, it strongly implies that the Rule of Two limits competition to only two firms. That's a gross misunderstanding that exists. I don't know where it came from, but it's out there. That is absolutely wrong. According to the census data, there are some 39,000 A/E firms in this country, and nearly 38,000 of them are classified as small.

Under a set-aside, every eligible small business can submit an offer as a matter of law. If that's true, in your industry, it's not the Rule of Two, but the rule of 38,000. See what I mean? So I think you didn't want to say that in your testimony.

Yes?

Mr. HUTCHINSON. If I could respond?

Mr. MITCHELL. Sure.

Mr. HUTCHINSON. Mr. Chairman. I think the point we're trying to make here is that the Rule of Two requires, under the Federal acquisition regulations, that all A/E contracts be set aside. And we believe that this is unfair. We think that there ought to be some contracts that would be open for competition among all interested firms, large and small. It was this reason, for example, that the Congress decided to amend the DOD Program, so that contracts under $85,000 would be set aside for small business, but contracts above $85,000, all firms, large and small, would be permitted to compete.

And our goal here is not to restrict competition, but to expand competition.

Mr. MITCHELL. Let me respond by saying that I honestly believe the issue here is size standards for A/E. If we got that resolved, then I really don't think you'd be here testifying this morning.

Mr. HUTCHINSON. If I could respond once more?

Mr. MITCHELL. Sure.

Mr. HUTCHINSON. Mr. Chairman, we agree completely. We're in heated agreement on this issue. We've worked for the better part of 10 years with the Small Business Administration to try to convince them to lower size standards, and they have taken a drastic step and they've reduced the size standards. And we've pointed out that well above 90 percent of our professions are still covered.

And this is, in our view, no meaningful reduction in the standard. We don't see in the foreseeable future that there would be any further reductions.

Mr. MITCHELL. Were you at the hearing when I advocated a size standard bill that I thought would treat everyone fairly, and was shot down? So, we're together.

Please, let the record reflect those changes.

I thank you for your testimony.

Mr. HUTCHINSON. Thank you, Mr. Chairman.

Mr. MITCHELL. But in all fairness, we have to look at the total small business community. You are in a not too good of a situation, here. On the other hand, many other businesses have significantly benefited from the Rule of Two. And I think it's the role of the Congress to sort of weigh all things and come up with the best possible solution, at least for that time.

Mr. PALATIELLO. May I make another comment, Mr. Chairman?

Mr. MITCHELL. Yes.

Mr. PALATIELLO. Let me first say that from our side of the table, we commend you and thank you for your leadership in trying to bring forward reductions in size standards, across the board, and particularly and specifically with regard to the design professions.

With regard to the last comment you made, we are only here testifying on behalf of a certain industry, with a great public interest that we're trying to serve on behalf of our clients. Perhaps, the OMB proposal falls in different ways on different industries, but we would argue, also, that the Rule of Two affects different industries in different ways.

And we feel we are particularly impacted by the Rule of Two.

Let me share with you a philosophical thought that I have. The gentleman from the Small Business Administration, I believe, Mr. Swain, testified last week that, and I think this is a direct quote, that the determination of size standards is quote "political" unquote.

He used the dredging size standards as an example. He said that he would get a letter from 10 very influential and senior Senators on one side of the issue and then a letter from 10 influential Senators on the other side of the issue. And he shrugged his shoulders and said, what are we to do.

Perhaps that's the same situation for the Small Business Administration in our case. I guess our feeling is whenever you adjust the size standard, there are going to be winners and losers; there are firms that are going to continue to be small business, and firms that will not.

Our feeling is that when you have a Rule of Two that results in a virtual total set-aside, that compounds the problem because then whenever you make that political decision, the losers are going to scream.

And our feeling is that lowering the size standard alone is not going to help the situation when you have a regulation in place that's going to continue to have total set-asides.

Mr. **Mitchell**. Let me respond to that.

Mr. **Palatiello**. Because, as Mr. Wallace indicated before, you can virtually always find two small engineering firms for virtually any contract.

Mr. **Mitchell**. Let me respond, very briefly. Then, I'll move onto the other members for questions.

I am certain that there are political influences on the agencies. I've been on this committee more than 12 years, and one of the things I've liked most about this committee is we don't sway with the political winds. It's really bipartisan in that sense.

Of course, there are pressures on the committee, but we end up making the decision that we think is right. So there may be, if I could just persuade SBA, and some of the members of this committee to go ahead and let us set the size standards, because there would be much less political impact than there would be if SBA had to do them.

Congressman Torres.

Mr. **Torres**. Well, I had a profound question, Mr. Chairman. I really thought I would have the witnesses on the run relative to this Public Law 98-577 and how it conflicts with the Rule of Two, but you stole my thunder. And most appropriately, because you are the author of that bill.

Mr. **Mitchell**. Congressman Gallo.

Mr. **Gallo**. Thank you. First, I'd like to thank you for this statement. It does have an awful lot of important material in there that I think will help us in the future.

Can you tell me how many of your companies, right now, or the percentage of the membership that are involved in Federal contracting?

Mr. **Hutchinson**. If I could try to respond to that. The Federal Government is the largest single client of the A/E professions. However, I would say that something on the order of 10 to 15 percent of the professions consider the Federal Government to be a major source of their income.

In other words, it's the big client, but the number of firms who participate in Federal work is relatively small.

Mr. Gallo. Again, I just want to thank you for your statement and also your written material. Thank you.

Mr. Mitchell. Congressman Bedell.

Mr. Bedell. Thank you, Mr. Chairman, and I'm sorry I'm so late. I didn't think I was going to be able to get here, at all, because I have major legislation from my Subcommittee on Agriculture in the full committee, but the markup was postponed until 2 o'clock, today.

Let me start off by saying I agree with you. The size standards should be lowered. It was lowered—apparently you feel not enough, is that correct?

How many members do you have in your organization?

Mr. Hutchinson. I would say there's over 100,000 because not all of these organizations represent private firms. There are some COFPAES organizations that have engineers in government, architects in government and academic professionals. In terms of practicing firms, you're talking about approximately 30,000.

In terms of members, you're talking about well over 100,000.

Mr. Bedell. OK. But 30,000 practicing firms, really?

Mr. Hutchinson. Roughly.

Mr. Bedell. Of those 30,000, about how many would be large firms according to, and not be small business firms according to the current SBA standard as it's now been lowered?

Mr. Hutchinson. We have statistics that we've placed in our statement, and as Mr. Wallace indicated, 99 percent of the surveying firms are considered to be small business. Roughly 95 percent of the engineering firms are considered to be small business, and 98 percent of the architectural firms are considered to be small business.

Mr. Bedell. So 98 or 99 percent would be small business according to this?

Mr. Hutchinson. Yes, sir.

Mr. Wallace. It's a fractional part that are big business.

Mr. Bedell. All right, I understand that you felt that the Boxer bill did not permit keeping the Rule of Two. Is that correct? Have you read that law? The entire law?

Mr. Wallace. Yes.

Mr. Bedell. Here it is. It isn't very big. Have you read it?

Mr. Hutchinson. Congressman, I'm not sure that we understand the question? We didn't question the Boxer bill. We referred to the proposal that the OFPP has recently put forward. This is what we're testifying about.

Mr. Bedell. It's Public Law 98-577, that's the Boxer bill. And it isn't like most of the bills we get around here. I thought you indicated in your testimony—maybe you didn't—that the wording of Public Law 98-577 indicated that the Rule of Two should be dropped?

Mr. Wallace. No.

Mr. Bedell. You did not say that?

You don't think—I just want to know, you do not think that Public Law 98-577 speaks against the Rule of Two?

Mr. **Hutchinson**. We think that there are various pieces of legislation that have recently been enacted by Congress, the thrust of which is to promote greater competition, for example, the Competition In Contracting Act. We feel that the Rule of Two limits competition, and that is our statement.

Mr. **Bedell**. Well, I don't know; I wasn't here. But you have no problem? You do not think that, you are not testifying that in your opinion, Public Law 98-577, which is the Boxer bill, supports your contention that they should not have the Rule of Two?

Mr. **Hutchinson**. We believe that the legislation that we have cited, the Competition In Contracting Act, Small Business Act that the chairman refers to, the intent of those laws are to promote competition, and we are saying that insofar as our industry is concerned, our profession is concerned, the Rule of Two restricts competition.

Mr. **Bedell**. Oh, well. Though I hadn't read it, I was told your testimony says that Congress intended to require the contracting officer to make an evidentiary showing of a need to use the set-aside procedure to obtain a fair portion of awards for small business.

And that's talking, apparently, about Public Law 98-577, I guess? Yes?

Mr. **Palatiello**. Mr. Bedell.

Mr. **Bedell**. My question, it's a legitimate question. Have you read the act? Yes or no?

Mr. **Hutchinson**. Yes, sir.

Mr. **Bedell**. You have read this act?

Mr. **Hutchinson**. Yes, sir.

Mr. **Bedell**. Have the other two of you read the act? Have you read the act?

Mr. **Wallace**. No; I haven't.

Mr. **Bedell**. Have you read the Act?

Mr. **Palatiello**. I have read the Act; yes, sir.

Mr. **Bedell**. Can I read it to you?

An executive agency may provide for the procurement of property or services covered by this section using competitive procedures, but excluding other than small business concerns in furtherance of sections 9 and 15 of the Small Business Act.

I don't know how you would say it any straighter than that. Just pure and simple, it says that this Act believes that the Rule of Two and small business set-asides are full and open competition.

If you read the act, you'd——

Mr. **Hutchinson**. We have a disagreement, sir.

Mr. **Bedell**. Did you read that paragraph?

Mr. **Palatiello**. Well, I heard you read it, and I heard you read it, yes, sir.

Mr. **Bedell**. Well, do you think that paragraph says that excluding other than small business concerns from a procurement in furtherance of sections 9 and 15 of the Small Business Act is still full and open competition? Do you think that doesn't say that?

Mr. **Hutchinson**. Mr. Bedell, our goal here and on behalf of the professions is to testify that there are various statutes that were enacted by the Congress, the intent of which, and I believe this is one of them, the intent of which is to promote competition.

And in our view, the Rule of Two does not promote competition for the A&E professions.

Mr. **Bedell**. Well, that's fine, if that's your testimony. But the law clearly says that the Rule of Two is proper competition. It's right there in black and white. And I guess the problem I have, is that we're doing an awful lot of things around this place. An awful lot of people don't understand these things, and people, such as you, come in and say this is what the law says. Unless we check the law ourselves, we tend to believe people like you.

Obviously, I'm not very pleased with you folks, as you are well aware. I don't know how the Hell—excuse me—I don't know how the heck you can have the gall to say we ought to have competition, and then say for architects and engineers, that price on all Government contracts is prohibited from being considered in the original selection of the architect and engineer.

I don't think the public knows that; I don't think the Congress knows that. I don't think anybody knows that. You've got 98 or 99 percent of your people who are small business, and then you come in and you not only testify against setting aside contracts for small business, but you also say that if small business can do these things more efficiently, they still don't have a chance to bid, because of the way the procedure works. I don't think people know that. I'm leaving Congress, and nobody's going to know it anymore. We try to increase competition, and you say that you think we ought to have price competition. That's what you've said in your testimony, except for architects and engineers.

And just so everybody knows what the law says. The law says that for architects and engineers, they will be selected according to who the Government thinks is the most competent and the law prohibits price as a consideration in that first selection process.

Three firms are selected. Then, from those three firms, the one that the Government thinks is most qualified is selected from that. The law prohibits price being a consideration in that selection. Even if the two top firms are equally qualified and one of them charges half the price of the other, the Government could not consider price in who they choose to negotiate with.

That's what we've got for architects and engineers. Now, this committee's done a lot of work to try to do something about Government procurement. And I think we've done some very substantial things.

But if you think for one minute, that a new small firm is going to be chosen as the one most competent to do the work under this type of a procedure, if a big firm wants it, we're just kidding ourselves. If you think for a minute, if they could do it for half, they are going to have any opportunity to let the Government know that, you're absolutely wrong. They're not going to.

We've eliminated the $400 hammers, but the reality is, in my opinion, and I've got to get it out in the public so everybody knows it, the reality is, you think since this is not a big issue for people, and there are architects and engineers in everybody's district, that you've got the political power to go ahead and keep your anti-competitive selection procedure.

It breaks my heart that that's the situation, but I think that is the deal. And I think until a time that somebody in the press, or somebody else wakes up to say that we ought to be a little bit concerned about the taxpayers, I think that architects and engineers are going to continue to have this unique procedure for all the things bought by the Government, the one group where you can't consider price in making the selection.

Now, it is true that if the Government cannot agree on a price with the most qualified firm, it can negotiate with somebody else. So, if the Government did not agree that they ought to buy a $400 hammer, they could go buy one for 2 bucks. The fact is, we got some people in Government that aren't that careful about buying hammers or purchasing other services.

And I think everybody knows that to be the case. The thing that disturbs me, it disturbed me when organizations like yours, 98 percent of whose members are small business, testify against setting contracts aside for that 98 percent of your people, so that the biggest 2 percent would have an opportunity on that. At the same time, you succeed in keeping in a law that I think is just absolutely a joke as far as the taxpayers of this country are concerned, and as we, as Congressman, are concerned.

I've made my speech. I guess I'm glad that the Agriculture Committee did adjourn so I could come make it. I don't think it's going to do one darn bit of good because I think you're right. I think you've got the political power to continue to say that there isn't going to be any price competition in architects and engineers services.

I tried to work with you; I agreed that it shouldn't be the major factor and it would be a disaster if all we did was take the lowest bid. But by gosh, if what we're going to say is you can't even consider price until after you've decided who you're going to negotiate with, I hate to think what we'd have in the rest of our Government, if that were true on all the things we buy.

I yield back the balance of my time.

Mr. MITCHELL. I think on that spirited note, we will thank you gentlemen, and call up the next witness.

Mr. WALLACE. Thank you.

Mr. HUTCHINSON. Thank you, Mr. Chairman.

Mr. MITCHELL. Want to make sure I'm pronouncing your name right. Sroka?

Mr. SROKA. Yes, sir.

Mr. MITCHELL. Our next witness is Mr. John W. Sroka, who is testifying on behalf of the Associated General Contractors of America.

We've received your testimony several weeks ago. All of us have had an opportunity to read it. I'd appreciate it, if you would make just your major points. The entire statement is submitted for the record.

Mr. SROKA. Yes; thank you, Mr. Chairman.

If I may, I'd like to introduce my colleague, Hubert Beatty, executive vice president of the Associated General Contractors.

TESTIMONY OF JOHN W. SROKA, EXECUTIVE DIRECTOR, OCCUPATIONAL DIVISIONS, ASSOCIATED GENERAL CONTRACTORS OF AMERICA, ACCOMPANIED BY HUBERT BEATTY, EXECUTIVE VICE PRESIDENT

Mr. SROKA. Mr. Chairman, members of the subcommittee, AGC has closely followed the controversy surrounding the Rule of Two. There are obviously those who argue that the Competition In Contracting Act requires change in the Rule of Two, and there are those who argue that it, in fact, does not require change in the Rule of Two.

AGC happens to fall into the camp of those who believe that the act does require a change in the Rule of Two. But, I do not appear before you today to argue for the elimination of the Rule of Two on that basis.

Whether the Rule of Two must be changed as a result of CICA, is a legal question, and one that's going to be resolved by people much wiser than me. Whether CICA requires a change or not, is really a secondary question.

We believe that the primary question is: "Is the Rule of Two really necessary," And my answer, at least for the construction industry, is, it is not necessary. It is not needed in the construction industry, simply because small business set-asides are not needed in the construction industry.

AGC represents over 8,000 general contracting firms, and in addition, 23,000 affiliate member firms. These consist of subcontractors and suppliers, as well as a host of others. We conservatively estimate that well over 80 percent of AGC's membership is small business, as defined by the Small Business Administration's size standards.

And these are firms who participate in small business set-asides. But they are also the same firms that tell us that they simply do not need small business set-asides to be competitive, or to obtain their fair share of Federal construction procurement.

It's been our analysis that the Rule of Two does not increase awards to small business, but rather, merely increases the number of contract that are set aside. This is borne out by statistics available from the Federal Procurement Data Center, and the Department of Defense.

For example, in 1983, when the civilian agencies used a sufficient number standard, they set aside 46 percent of their construction contracts. In comparison, DOD agencies, in that same year, using the Rule of Two, set aside 77 percent of their construction contracts.

Yet, in that same year, overall small business awards to construction contractors in the civilian agencies amounted to 90 percent, as compared to 89 percent for DOD. I think these statistics tell us two things: First, that the Rule of Two standard used by DOD did not increase construction awards to small business, as compared to the civilian agencies.

And second, it tells us that 44 percent of the civilian agencies' construction contract awards to small business were obtained through pure free and open competition without any artificial set-aside limitations. That is, of the 54 percent of construction contracts from the civilian agencies that were not set aside, small business was successful on 81 percent of these.

And this latter point is precisely the message that AGC receives from its small business members; that set-asides are simply not necessary in the construction industry. Set-asides and their implementing tool, the Rule of Two, only accomplish two things in construction.

First, they restrict competition; and second, they increase the cost of construction, and both of those are to the detriment of the taxpaying public.

Mr. Chairman, whatever need there may be in other industries, or for other types of procurement, there is no need for the Rule of Two in construction procurement, just as there is no need for set-asides programs in construction.

Thank you very much.

[Mr. Sroka's prepared statement follows:]

PREPARED STATEMENT OF JOHN W. SROKA, EXECUTIVE DIRECTOR, OCCUPATIONAL DIVISIONS, ASSOCIATED GENERAL CONTRACTORS OF AMERICA

AGC is:

* More than 32,000 firms including 8,400 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;

* 108 chapters nationwide;

* More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilitiy facilities.

The Associated General Contractors of America (AGC) is an association of some 32,000 firms, including 8,400 general contracting firms. Approximately 90 percent of AGC's general contractor member firms are small businesses, as defined by SBA's size standards. AGC strongly supports the proposed change to the Federal Acquisition Regulation (FAR) on Small Business Set-Aside Determinations to implement provisions of the Competition in Contracting Act of 1984 (CICA), as published in the Federal Register of May 22, 1986 at page 18810.

In the interest of advancing equal opportunity for all Americans, AGC continues to recommend open competitive bidding with award to the lowest responsive and responsible bidder. This system, and this system alone, guarantees no discrimination against any citizen or firm. Contrast that system with the discrimination inherent in a "rule of two" that automatically discriminates against all firms which do not meet the SBA's ever-changing size standards for small business. The "rule of two" is not only blatantly discriminatory against firms not meeting the SBA's size standards, it also blatantly discriminates against those firms' employees.

AGC supports this proposed change, which will replace the FAR's current "rule of two" standard for determining when a procurement must be set aside for restricted competition among small businesses with the "sufficient number" standard contained in the CICA, for the following reasons: 1) The "rule of two" has absolutely no basis in statute; 2) The "rule of two" is totally inconsistent with the requirements of the Competition in Contracting Act; 3) The "rule of two" is an unreasonable and costly barrier to greater competition in the Federal Government's construction procurement activities; and 4) The "rule of two," and indeed the small business set-aside program itself, are not needed in construction to "assure" that "small businesses," however artifically defined by SBA's ever-changing size standards, receive a "fair proportion" of government construction contracts. The inherent characteristics of the construction industry and the competitive bid process have historically worked to assure an ample opportunity for qualified construction firms of all sizes to compete for and obtain federal construction contracts.

AGC strongly urges the adoption, as a final rule, of the FAR change being proposed by OFPP. Elimination of the "rule of two," despite the misleading arguments and statistics being profferred by those who favor continued use of the "rule of two," is in the best interests of the entire construction industry, the Government and the taxpaying public. AGC's reasons for supporting the OFPP proposed rule change are further discussed below.

The "Rule of Two" Has No Legal Basis Whatsoever

The use of the "rule of two" by federal agencies has never been mandated in statute. While the Defense Department, in 1978, cited amendments to the Small Business Act as requiring its use of the "rule of two," the civilian agencies, interpreting the same Act, did not find themselves required to incorporate the standard into the Federal Procurement Regulations. The "rule of two," in fact, found its way into the Federal Acquisition Regulation in 1984 without even the benefit of public comment. A subsequent request for comments on the "rule of two," published at the urging of thirty Congressmen and Senators, found 65 percent of those submitting public comments to be in opposition to the rule. Far from being an expressed statutory requirement, the "rule of two" has actually been considered and rejected by the Congress. In 1984 the House of Representatives, at the urging of numerous Committee Chairmen and Ranking Minority Members, chose to not consider H.R. 2133, a bill which would have given statutory authority to the "rule of two."

The "Rule of Two" Violates the Requirements of the Competition in Contracting Act

The Competition in Contracting Act of 1984 made full and open competition the standard for all Federal procurements, including those made under set-aside programs. Section 2732 of the CICA contained the following requirement:

> "...the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs."
> H.R. Rep.No.98-861, 98th Cong.2d Sess.1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids...(to achieve) the lowest reasonable cost..." as a standard of competition for all procurements

"...including those made under set-aside programs," AGC believes that, when making the original determination to set aside a particular procurement for exclusive small business participation, contracting officers should now be required to demonstrate that there will be a sufficient number of small business bids to fulfill the Government's requirements at the lowest reasonable cost.

The intent of Congress in passing the CICA is clear. Congress intended to redefine the requirements for competitiveness to permit greater flexibility for the Contracting Officer to maximize opportunities for competition in meeting the Government's procurement needs. The "rule of two" is plainly violative of the requirements of CICA in that it does not maximize full and open competition, as required by the Act. Rather, it requires restricted competition when a contracting officer merely expects that two small businesses will have an interest in bidding on a project. This results in restricted set-asides, without the development of empirical evidence to justify the decision to restrict competition. Such is clearly inconsistent with the full and open competition mandate of the Competition in Contracting Act.

When the Competition in Contracting Act became effective in April 1985, the FAR should have immediately been amended to replace the "rule of two" test with a "sufficient number" test, thereby bringing this section of the FAR into conformity with the Act. More than one year later the FAR has still not been amended, despite the glaring inconsistency between the Act and the "rule of two," and despite the many public comments OFPP received in opposition to the "rule of two" at the end of 1984. Clearly, it is time to finally bring the FAR into conformity with the Competition in Contracting Act.

The "Rule of Two" Increases Costs and Inhibits Competition

It is entirely compatible with principles of good government for the entire federal procurement process to be based on a standard of full and open competition, so that procuring agencies will receive goods and services at the lowest possible overall cost. The "rule of two," which requires agency officials to restrict competition by setting aside contracts whenever they think two small firms might want to perform the work, clearly interferes with this standard, and in doing so deprives the public of the opportunity to see its tax dollars expended in the most prudent and efficient manner. Once a contract is set aside for restricted competition among small businesses, any company which happens to be "larger" than the artificial size standard created by SBA for that industry, is precluded from bidding on the contract, even if it is capable of performing the work at a lower price.

The "rule of two" standard is clearly anti-competitive. Instead of promoting competition, it mandates an automatic triggering mechanism for what is virtually a "sole source" (just two firms) procurement, rather than promoting full and open competition by accepting bids from all interested firms. Under normal economic conditions the "rule of two" drastically alters the construction market by changing its competitive nature. With existing economic conditions, the "rule of two" totally distorts the construction market. For the past several years, it has become common for 10 to 15 contractors to bid on available federal construction contracts, and not unusual for even the highest of these bids to be below the government's estimate. Application of the "rule of two," in this type of bidding climate, leads to the totally undesirable result of nearly 100 percent of all federal construction contracts being set aside for restricted bidding by small businesses. The current FAR language leaves Contracting Officers with no discretion in making the choice to restrict competition: there are no guidelines as to what represents a "reasonable price" (lowest price, rather than "reasonable price," should be the standard for award); there is no requirement that the contracting officer look at the requirements of the project to see if it is even within the capabilities of a small business; he or she only need guess that any two small business firms may be willing to bid on the project.

The "Rule of Two" and Small Business Set-Asides Are Unneeded in Construction

The construction industry does not need the "rule of two" or small business set-asides to "spread opportunities equitably" for Federal construction contracts. The characteristics of the industry and the competitive bid process assure all firms ample opportunity to compete for and obtain government construction contracts.

The construction industry is truly one of the last bastions of the free enterprise system, and as such, is a national haven for small businesses. This industry is typified by family-owned businesses which jealously guard their integrity and reputation in the community, in an extremely competitive and open industry. Construction is not dominated by a few firms, rather it is dominated by the open competitive bid system. That is, competition in terms of price and ability to complete the task determines which companies win contracts. Depending on the nature of the construction project, the general contractor may complete the work with its own forces, or may subcontract the speciality work as is necessary to complete the job.

The construction industry is also one of but a few that permit an individual -- any individual -- to make a start with little or no capital. An emerging construction firm generally uses credit to buy materials and arranges for short term loans to pay for equipment rental and labor costs. This ease of entry into the industry helps to safeguard and assure competition in the industry.

In 1963 the Administrator of the Small Business Administration directed that a study be instituted to look at the construction industry to detail its characteristics. The study looked at the economic factors that influence the industry to determine if the then-emerging SBA programs were applicable to construction. The findings of the study are as follows, and are as valid today as they were in 1963:

- "There can be no question but that the application of any measures of competitiveness to the building and construction industry would result in the conclusion that it should be ranked among the least concentrated or most competitive. It is not dominated by a few large firms.
- The industry is comprised of a very large number of enterprises.
- The industry is comprised of small enterprises by conventional standards.
- There is a very high rate of business births in construction. None of the major industry categories had an entrance rate as high as construction.
- The financial costs of entry to the industry are relatively low in many branches. Equipment may be rented. Workmen typically furnish their own tools. In many cases owners and clients may advance part of the capital.
- The scale of operations in the construction industry reaches efficient levels at a relatively small size. The technology of the industry does not require large scale operations and large capital costs, compared to industry generally, in order to achieve efficient operations.
- Construction enterprises have few fixed costs and move readily from locality to locality and even region to region, increasing materially the degree of competition in a single locality. Working opportunities attract bidders from far and wide.
- The bidding takes place on a specifically defined project. All bidders are furnished the same specifications and plans, and in the typical case, the competitors are bidding on a precisely defined and identical product.
- The subcontracting system, characteristic of construction projects, enhances the competitive nature of the industry. Each successful bidder may consider whether to perform the work or subcontract a portion of it in turn.

- o Contractors face keen competition from prospective clients who prefer to perform work themselves. Industrial enterprises, householders, and local, state and federal government agencies affect competitive conditions in construction by performing an appreciable amount of construction work themselves.

- o The above features of the construction industry suggest that the construction industry is already relatively highly competitive among sectors, and that the need for using the influence of federal contracts to increase competitiveness deserves a low priority in construction. The use of set-asides in construction needs to be placed in this perspective."

AGC believes these facts lead inescapably to the conclusion that the characteristics of the construction industry assure ample opportunity for qualified contracting firms of all sizes to obtain a share of federal construction outlays.

Large firms, for example, place themselves at a competitive disadvantage if they compete for a project that is too small for them since they have to assign key management or supervisory personnel to such projects, or have to acquire such personnel. At the same time, larger firms have to commit some of their bonding capacity for these small projects with the result that when they contemplate bidding on projects in their own construction marketplace level they are at a disadvantage with their real competitors because they may have dissipated their management and supervisory skills, their bonding capacity and their financial resources on projects that are outside the scope of their natural market area.

Despite the fact that the small business set-aside program is unneeded in construction, this industry has continually been overly relied upon by certain federal construction procuring agencies, particularly agencies within the Defense Department, to meet their small business procurement goals, not the least reason of which has been the use by these agencies of the "rule of two."

Despite the historical overuse of small business set-asides by DOD agencies, a comparison of construction contract award data between DOD and the civilian agencies (especially when the civilian agencies were using a "sufficient number" test and DOD was using the "rule of two" test) illustrates a very important fact: while use of the "rule of two" may increase the number of construction contracts set aside for restricted bidding by small firms, it does not result in an overall increase in the share of contracts awarded by agencies to small businesses.

- o For example, in 1983, when the civilian agencies used a "sufficient number" standard, they set aside 46 percent of their construction contracts for exclusive bidding by small businesses.

- In contrast, DOD agencies in that year set aside 77 percent of their construction contracts.

- Yet, in 1983, small businesses were awarded 90 percent of the civilian agencies' construction contracts compared to 89 percent for the DOD agencies.

The "rule of two" does not increase the participation of small business construction firms in the Government's procurement activities; it only increases the number of contracts set aside for restricted bidding by small business. These firms could obtain just as many contracts without the "rule of two" or the set-aside program. In the construction industry small businesses are extremely competitive. They are quite capable of competing head to head with firms that do not qualify as small according to SBA's ever-changing definitions.

In the private sector there is no such thing as a small business set-aside program. Here the open, unrestricted competitive bid system determines which firm will be awarded the contract. In the private sector smaller construction firms thrive and are able to obtain a "fair proportion" of the available market. AGC recommends that the Federal Government eliminate small business set-asides in its construction procurement activities, thereby permitting the free market in construction to work -- and it will work in the public sector as it demonstrably works in the private sector.

Mr. MITCHELL. Thank you very much for your statement.

When was the Association of General Contractors founded?

Mr. SROKA. 1918, sir.

Mr. MITCHELL. 1918. The Small Business Act came into being in 1953. What was the position of the Association of General Contractors with regard to the Small Business Act itself?

Mr. SROKA. I would suspect almost immediately we were opposed.

Mr. MITCHELL. I think you are right. Your outgoing president met with me and said that even from the beginning of the Small Business Act, AGC opposed it.

I thought we ought to have that on the record, because whatever happens with regard to the statements and positions taken by AGC, obviously you are coming from a rather fixed ideological position that dates back to at least 1953.

On page 2 of your statement, you indicate that the Rule of Two by Federal agencies has never been mandated into statute; is that correct?

Mr. SROKA. Yes, sir; that is what it says.

Mr. MITCHELL. Then I will have to tell you that that is an incorrect statement. Section 15(j) of the Small Business Act, as amended by Public Law 95-507, mandates the use of the Rule of Two for every procurement contract under $10,000, in amount which is subject to small purchase procedures. Did you know that?

Mr. SROKA. No, sir; Does that section actually use the words "Rule of Two"?

Mr. MITCHELL. That is right.

Mr. SROKA. No, sir; not aware.

Mr. MITCHELL. It is mandated by law. So that is an incorrect statement in your testimony.

Mr. SROKA. That is just for small purchase procedures.

Mr. MITCHELL. Right. Now let us look at page 2 again.

On page 2 of your statement, you say that the Rule of Two has actually been considered and rejected by the Congress; is that correct?

Mr. SROKA. I believe we note that——

Mr. MITCHELL. No; did you say that in your statement?

Mr. SROKA. I don't know, I would have to check.

Mr. MITCHELL. Page 2.

Mr. SROKA. Yes.

Mr. MITCHELL. The Rule of Two has actually been considered and rejected by the Congress.

Mr. SROKA. Actually been considered and rejected by the Congress. Yes, sir.

Mr. MITCHELL. That, too, is an incorrect statement. The Rule of Two was never rejected by the Congress.

You cite the situation, though, of H.R. 2133 as support for your statement, but that bill was never even brought to the floor of the House. So there could be no rejection if the bill did not get to the floor.

Let me ask you, you are heavily tilted toward sufficient number, lowest reasonable cost standards. If that were adopted, would it not cause a severe disruption in the acquisition process? Why could not a small business protest the failure of a contracting officer to set aside a construction contract on the grounds that there is a sufficient number of small businesses likely to respond to the solicitation, so that the Government can get the lowest reasonable cost?

Given your statement about the competitiveness of the industry and the overly generous size standard, is it not possible that we would get numerous protests, a multiplicity of them, a plethora of them, without a definitive test for set-asides? The vagueness of the words "sufficient number and lowest reasonable cost," it seems to me, suggests that the protests would just mount and cascade over the roof of each procurement agency.

Would you comment on that?

Mr. SROKA. Yes, sir; I believe that the civilian agencies use the sufficient number test for a number of years. So apparently it was workable, No. 1.

No. 2——

Mr. MITCHELL. But it was not.

Mr. SROKA. Pardon me?

Mr. MITCHELL. It really was not, but you go ahead and make your statement.

Mr. SROKA. No. 2, we would support a sufficient number standard as a first step. The ideal step, quite frankly, would be no standard whatsoever, because we do not believe that there really should be set-asides in the construction industry.

I do not know if you would get a large outcry of objections if the Rule of Two standard were changed—or if you went to a sufficient number standard.

I can tell you that based on the 80 percent or so of our membership who are small business, you would not get that outcry. The consistent message that we keep on hearing from our membership is that they do not believe that set-asides are necessary. That would lead us to believe that they most assuredly would not believe that a Rule of Two is necessary.

Mr. **Mitchell**. Well, then the outcry would come from all others who are not members of your association, or many of them.

Mr. **Sroka**. Well, when you look at the number of construction associations that are established, and you start to take out the overlapping membership—we represent about 8,000 or so general contractors—I would suspect that of those that belong to other associations that presumably have some type of representation, there may be another 3,000 or so. I do not know if their small business members would have any different feelings than AGC's. I could not imagine why AGC's small business members would be any different than——

Mr. **Mitchell**. Well, for example——

Mr. **Sroka** [continuing]. Small business construction contractors anywhere.

Mr. **Mitchell**. First of all, I would think that certainly the Association of Minority Contractors would raise holy hell, based on an exclusion. They are not members of your outfit. And I can cite many others.

Mr. **Sroka**. Well, NAMC is an association itself that would not be a member of another association like AGC.

Mr. **Mitchell**. But you have overlap.

Mr. **Sroka**. Yes; we have overlapping membership.

Mr. **Mitchell**. So there could be overlap. In fact, I believe there is at least one member of AGC who is also a part of the Association of Minority Contractors.

Let us get back to your statement, which I found fascinating. On page 4 of your statement, you say that under the Rule of Two, there is no requirement that the contracting officer look at the requirement of the project to see if it is even within the capabilities of small business. Reading further from your statement, he or she only need guess that any two small firms may be willing to bid on the contract.

Is that a correct reading of your statement?

Mr. **Sroka**. Yes; it is.

Mr. **Mitchell**. OK, and that statement is incorrect.

The Rule of Two requires that the contracting officer have a reasonable expectation, requires this, a reasonable expectation of receiving offers from at least two responsible small business concerns. Responsibility is a term of art in contract law and is defined in part 9.104-1 of FAR.

In specific, in order to be a responsible contractor, the contracting officer must determine that the contractor has met a number of different tests. Let me just read to you the relevant parts of that section, Section 9.104-1.

General standards. To be determined responsible, a prospective contractor must have adequate financial resources to perform the contract or the ability to obtain them; (b), be able to comply with the required or proposed delivery of the performance schedule, taking into consideration all commercial and governmental business commitments; (c), have a satisfactory performance record; (d) have a satisfactory record of integrity and business ethics. Right down the line.

So your statement is totally inaccurate.

Mr. SROKA. If all of those are actually being implemented out in the field, then we have great difficulty in trying to explain some of the aberrations that appear in the set-aside program.

Mr. MITCHELL. Be very careful, now; be very careful. Your statement says that there is no requirement, and I am correcting you and saying that these are the requirements. And I would also urge you to be very cautious, because I do not think you want to blanketly indict or cast aspersion on all contracting officers.

Mr. SROKA. No, sir.

Mr. MITCHELL. You say it was not being implemented, so I am just——

Mr. SROKA. I have a specific example, if you would like.

Mr. MITCHELL. Oh, yes; you may have an example, but I do not like this business of the broad brush painting all people, so that is why I thought I had better start with that point.

I have a lot more questions. I thought it was important to clear up the inaccuracies and the faulty statements made in your testimony. I will try to come back with some more questions in a moment.

Congressman Savage, do you have any questions?

Mr. SAVAGE. No.

Mr. MITCHELL. Mr. Gallo.

Mr. Bedell.

Mr. BEDELL. Sure.

You take these stands—how are these stands determined? You have a board that determines them, or a committee, or how are they determined?

Mr. SROKA. I would suspect that we operate much like Congress operates. We have about——

Mr. BEDELL. God help you.

Mr. SROKA [continuing]. We have about 67 committees within AGC; volunteer members of the association serve on those committees. They meet in open forums. They discuss issues, recommend policies.

In the set-aside area, for example, my guess would be that probably 30 of the 67 committees have jurisdiction, if you will, that would allow them to address the set-aside issue. Once the committee makes a recommendation on a particular issue, that recommendation then goes before our full board of directors, 350 members, for a vote.

Mr. BEDELL. You have 350 members on your board of directors?

Mr. SROKA. That is correct.

Mr. BEDELL. How many of those are small business people; do you know?

Mr. SROKA. I do not think we have ever really gone through to classify them. My guess would be that since about 80 percent of our membership is small business——

Mr. BEDELL. No; that is not a way to guess.

Mr. SROKA. OK. Well, I——

Mr. BEDELL. What do you want to do, do you want to send us a list, so——

Mr. SROKA. All right.

Mr. BEDELL [continuing]. Or a compilation of——

Mr. **Sroka**. Sure. I would—we would have to go through——

Mr. **Bedell**. Anybody would guess that, but I find that is not the case, certainly, for the chamber. I erred in not asking the architects and engineers. I have my suspicion.

But certainly that is not the case for most—for many organizations, and that is one of the big concerns I have, is that those organizations, since they are run by the minority in terms of small versus big, that then the decisions are made contrary to the wishes of their membership.

Now, whether it is contrary to their wishes or not, certainly you would not argue but what the Rule of Two is there to benefit small business. I presume you would agree with that?

Mr. **Sroka**. Yes.

I do not think AGC would fall into that categorization. Our senior vice president, for example, who will be the president next year, is a contractor with an average annual volume of about $3 million; and our vice president, who will be president 2 years hence, has an average annual volume of about $5 million. So I think there is probably a——

Mr. **Bedell**. OK.

Mr. **Sroka** [continuing]. Good representation of——

Mr. **Bedell**. I am not accusing you, because I do not know, but I do know how some of the other organizations operate.

I do not have much to say. I guess the only concern I would have is I do not really think it is right for you to say that as you compare, at the last, what happens in civilian contracts compared to what happens in Government contracts necessarily proves anything. The concern we have is not how we compare with civilians. The question is what would happen if we did not have the rule.

Mr. **Sroka**. I understand.

Mr. **Bedell**. And certainly the experience that some of us have had is that there are people in Government who would much prefer to deal with the big boys than the little guys, because it is a lot simpler for them to do. And that is a concern that many of us have, and I have to tell you, some of us are terribly puzzled where we try to do something to help our small business people, and then their organizations come in and say, well, we are more in favor of the big guys than the little guys; we really do not want you to do anything to help the small business people.

That is very difficult for some of us to understand, and I have to tell you, in talking to my constituents, when they understand what the issue is, they do not agree with what is—that is not 100 percent true—but generally, when we explain to them what we are trying to do, my constituents do not feel that way.

And I think very frequently these organizations simply get to where they are dominated by the big people, because they put in the most money. Is that the way your dues work, or not? Does the big person pay more dues than the little guy?

Mr. **Sroka**. Yes; he does.

Mr. **Bedell**. OK. They put in more money than the little guys, so they have a bigger voice. So they then put the information down to the little guys many times, and I did not go over it, but many times I do not think objectively in terms of putting the issue to them. So they get the little guys to agree with it so they can take the little guys to the slaughter.

Now, that is exaggeration, going to the slaughter, but the reality is that we are trying to do something for small business and we have organizations, 90 percent of which are small business, coming in and saying, oh, you should not do that; you ought to be sure that we get plenty of business to the big guys instead of the little guys.

That is the problem some of us have in our mind, and you need to understand it.

Mr. SROKA. Mr. Bedell, your concerns are certainly understandable and are probably very accurate, applied to some industries or some types of procurement. You have indicated, for example, that there might be a tendency for the Government to want to deal with just the big boys, and that may be true in some types of procurement in the Government.

But when you look at how construction is procured in the Federal sector, through a sealed-bid method, it is very difficult for the Government to try to choose a large contractor over the small contractor. All he chooses is the lowest bid; once that envelope is ripped open, size makes no difference.

Mr. MITCHELL. Just one last question.

Mr. SROKA. Yes, sir.

Mr. MITCHELL. And I have to give you a little bit of the background. In around 1962 or 1963, there was a great deal of ferment about—beginnings of ferment about civil rights, and there was a report that I found absolutely intriguing. It said the Negro in the South does not find the situation of segregation particularly onerous or degrading. That was in 1963.

I always have trouble when they go back and look at reports that are 23 years old and try to apply them to a current situation. I think, for example, if the House Judiciary Committee had that study done in 1963 they would laugh at it.

But you, on page 5 in your testimony, summarize a report from the SBA that is 23 years old. Did you make any attempt to update that report?

Mr. SROKA. The report was not done for us. It was done for the SBA Administrator. We were——

Mr. MITCHELL. Right, 23 years ago.

Mr. SROKA. Right. We were—we cite it only because we were unable to find any other report that may have been done by or for SBA which specifically addresses what this one did, and that is what does the construction industry look like in terms of competitiveness, and does it need the same assistance as other industries?

Mr. MITCHELL. Since that was the only document available to you, I gather you studied it very carefully?

Mr. BEDELL. Careful.

Mr. SROKA. Maybe we can just have your question before I answer that.

Mr. MITCHELL. May——

Mr. SROKA. I have read the study; I have not read it recently.

Mr. MITCHELL. All right. To the best of your recollection, in any part of that report was there a recommendation for eliminating set-asides in the construction industry?

Mr. SROKA. No.

Mr. **Mitchell**. No.

Thank you very much for your testimony.

Mr. **Beatty**. Mr. Chairman, I wonder if you would——

Mr. **Mitchell**. Oh, I am sorry.

Mr. **Beatty** [continuing]. If you would possibly indulge a few comments that I would like to offer in response to comments made?

Mr. **Mitchell**. Well, wait just a moment. Mr. Torres—I am sorry—has questions.

Mr. **Torres**. I just wanted to ask a general question of the witness for my own information.

In a situation of open competitive—or, open competition in Federal construction contracts, how many firms generally bid on a contract?

Mr. **Sroka**. It is not unusual for us to see 10 to 15 firms bidding on a construction contract.

Mr. **Torres**. Ten to fifteen firms. I ask the question because earlier Mr. Heatherly, who was here testifying that under the Rule of Two that the Department of Defense averages 10 small businesses, bidders, on each set-aside. And I understand NASA, I think he said, 12, and GSA, 10. That was an informal survey they took.

You are saying 10 to 15?

Mr. **Sroka**. Um-hm.

Mr. **Torres**. Thank you.

Mr. **Mitchell**. Any further questions?

Mr. **Torres**. No further questions.

Mr. **Mitchell**. Any further questions from members of the committee?

I heard your request. I would like very much to indulge you, but I cannot. Let me explain why.

We are dealing with the sanctions bill against South Africa on the floor, and I am scheduled to speak on that somewhere between quarter of and 11 o'clock.

I would be most appreciative if you would reduce your comments to writing, and I will share them; we will have them reproduced and shared with all the members of the committee.

Mr. **Beatty**. Appreciate it.

Mr. **Mitchell**. Thank you for your cooperation.

Mr. **Sroka**. Thank you.

Mr. **Mitchell**. The committee now stands adjourned.

[Whereupon, at 11:41 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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APPENDIX

APPENDIX A.—CORRESPONDENCE AND EXHIBITS SUBMITTED BY JOSEPH R. WRIGHT, JR., DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

March 27, 1986

The Honorable Joseph Wright
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear ~~Mr. Wright:~~ Joe:

I am writing to express my great concern and surprise at the news that the Office of Federal Procurement Policy (OFPP) has forwarded its proposal to eliminate the "rule of two or more." This rule establishes the mechanism through which Federal contracts are set aside for small business competition. I am concerned because of the importance of the rule to agencies in utilizing small business contracts and because of the contrary action on the specific issue taken by the Congress in 1984. I am surprised because of our direct agreement with Bill Mathis last year that the SBA would take action on specific size standards, the real source of the concern with the "rule of two or more," and that OFPP would confer with SBA before any action was taken on this issue. Over the last several months, SBA has taken action on several problem size standards. Nonetheless, OFPP has come out with their proposal without any of the normal or promised consultation with SBA.

The premise for the OFPP proposal is that conflict exists between the "rule of two or more" and the Competition in Contracting Act of 1984, which requires, to the maximum practicable extent, the award of contracts through full and open competition. I think that we are in agreement with GSA, DOD and NASA that no such conflict exists. Illustrative of the collective views on this issue is the statement by the agencies in a recent Defense Acquisition Regulation Council case:

> Our concern with OFPP's position with respect to the "Rule of Two" is that it reflects a fundamental misapplication of CICA's requirements for "full and open competition." The term "full and open competition" is defined in the OFPP Act to mean "that all responsible sources are permitted to submit sealed bids of competitive proposals on the procurement." CICA, as amended by Pub. L. 98-577, recognizes that small business set-asides are full and open competition. The language at issue in 41 U.S.C. 414 contains an instruction for agencies to increase their use of full and open competition by establishing policies and procedures to assure that the Government receives a

> sufficient number of sealed bids or competitive proposals to fulfill its requirement at the lowest reasonable cost. In terms of CICA, this means agencies should use advanced procurement planning, CBD synopsizing and specifications which are not unnecessarily restrictive (DAR Case 86-709).

The small business set-aside is an important procedure through which small businesses can fully and openly compete with their peers for a fair proportion of Government purchases. This program, created by the Small Business Act of 1953, has been national policy for more than 30 years. Weakening of the set-aside program through implementation of the proposed FAR changes would undermine the effectiveness of the policy to provide maximum practicable procurement opportunities to small business.

It may be instructive to examine the programmatic aspects of the set-aside program with a general discussion of how DOD, the largest procuring agency, participated in the set-aside program utilizing the "rule of two or more":

-- In the past five fiscal years, the DOD has awarded approximately 50 percent of its small business contract awards to small business as set-asides. These were set-aside awards not because DOD is moved by altruistic considerations, but rather that DOD contracting officers recognize that (1) the value of contracting with small businesses which provide high quality goods and services at reasonable prices, and (2) that the "rule of two or more" does not delimit, curtail or inhibit "full and open competition." What it actually does is to create a rational, quantifiable procurement environment in which contracting officers can both confidently serve the goal of maximum practicable participation by small business, and fulfill the immediate procurement requirement of the buying agency.

-- Most recently, in Fiscal Year 1985, DOD made $139.6 billion in total contract awards. Of this, $26 billion or 18.8 percent of total awards were made to small business. DOD reports that $14 billion or 53 percent of the $26 billion was awarded as set-asides. Based on DOD total awards, large business received 81.2 percent versus 18.8 percent awarded to small business. There is no evidence that DOD utilization of the "rule of two or more" procedure limited competition. In fact, using the current procedures, DOD averages 10 small businesses bidding on set-asides; NASA, 12; and GSA, more than 10. Unrestricted procurements do not bring in this number in most instances. Thus it appears that application of the rule is leading to increased competition for Federal contracts in areas where small firms are efficient performers.

-- Nothing in the rule of two or any other set aside procedure relieves any agency from the obligation of making its awards on solidly based business judgments.

Changing the "rule of two or more" standard to one of "full and open competition" would direct procurement officers to set aside for small business competition any contract where there is a "reasonable expectation that full and open competition exists." No guidelines are offered to contracting officers to make this determination. The result would be uncertain, inconsistent and unpredictable contract procedures.

The proposed change would abolish the rule and is not legally necessary. Based on our experience, I believe the impact to the set-aside program would be devastating. If there are problems in particular categories of procurement, we can help fix them. Elimination of the "rule of two or more" is an unjustified overbroad approach to procurement reform. We would be happy to meet and participate with OFPP and other interested parties, e.g., DOD, NASA and GSA, to further examine your concerns regarding the "rule of two or more."

Yours truly,

James C. Sanders
Administrator

cc: Honorable William A. Taft, IV
David Baker

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

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OFFICE OF THE ADMINISTRATOR

Honorable Charles Heatherly
Acting Administrator
U.S. Small Business Administration
Washington, DC 20416

Dear Mr. Heatherly:

This is in response to a letter dated March 27, 1986 from Mr. Sanders concerning the "rule of two." I believe the enclosed questions and answers respond to most of the comments Mr. Sanders had on this proposed FAR revision.

However, there are a couple of issues regarding the purpose and effect of this regulatory change which I believe require clarification. The letter stated that the premise for the proposal is that conflict exists between the "rule of two" and "full and open competition" as expressed in the Competition in Contracting Act of 1984. The proposed change is not based on the "full and open competition" definition but on the following additional requirement of CICA:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> > (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. The proposed standard is not, as stated on the last page of Mr. Sander's letter, a "reasonable expectation that full and open competition exists."

It should be emphasized that the proposed regulation change is intended as appropriate implementation of the Competition in Contracting Act and that it is not a statement that the Executive agencies have been conducting anti-competitive procedures in their current small business set-side regulations.

If we can be of further assistance, please contact Mr. William Maraist on 395-3300.

Sincerely,

Joseph R. Wright, Jr.
Deputy Director

Enclosure

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

ICE OF THE ADMINISTRATOR

MAY 28 1986

Honorable James C. Miller III
Director
Office of Management and Budget
Washington, D. C. 20503

Dear ~~Mr. Miller~~ Jim:

I am writing to let you know my personal concerns about the Office of Federal Procurement Policy proposal to eliminate the "rule of two." I have reviewed and concur with the letter of my predecessor, Jim Sanders, to Joe Wright dated March 27, 1986 (copy enclosed) which states that the proposal will weaken the small business set-aside program.

As you know, the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration have also voiced concerns over the proposal. I do not believe that Joe Wright's response to Mr. Sanders' letter adequately responds to the many concerns raised by a number of agencies. We will be commenting formally on the proposed rule published in the Federal Register at a later date.

I would be happy to meet with you to discuss this matter at your convenience.

Sincerely,

Charles L. Heatherly
Acting Administrator

Enclosure

Mr. James Graves
Office of the Federal Register
National Archives and Records Service
Washington, DC 20408

Dear Mr. Graves:

Enclosed for publication in the Federal Register is a proposed rule on "Small Business Set-Aside Determinations" to implement provisions of the Competition in Contracting Act of 1984 (P.L. 98-369).

Please inform us of the Federal Register issue containing the notice.

Sincerely,

Darrell A. Johnson
Deputy Associate Director
for Administration

Enclosure

cc:
Official File
DO Chron
DO Records
Deputy Director
General Counsel
Mr. Johnson
Mr. Coleman
Mr. Maraist
Mr. Baker
OFPP Chron/Reading
OFPP:W Maraist:CClark:mbd 4/25/86

OFFICE OF MANAGEMENT AND BUDGET
OFFICE OF FEDERAL PROCUREMENT POLICY
48 CFR Parts 6 and 19

FEDERAL ACQUISITION REGULATION: SMALL BUSINESS SET-ASIDE DETERMINATIONS (RULE OF TWO)

AGENCY: Office of Management and Budget, Office of Federal Procurement Policy (OFPP).

ACTION: Proposed Rule

SUMMARY: OFPP is requesting comments on a proposed change to the Federal Acquisition Regulation (FAR) on Small Business Set-Aside Determinations to implement provisions of the Competition in Contracting Act of 1984 (P.L. 98-369).

DATE: Comments are due on or before July 1, 1986.

FOR FURTHER INFORMATION CONTACT: William S. Coleman, Jr., Office of Federal Procurement Policy, OMB, 726 Jackson Place, N.W., Washington, DC 20503, (202-395-3501).

SUPPLEMENTARY INFORMATION:

A. Background: Prior to the Federal Acquisition Regulation (FAR), the Federal Procurement Regulation (FPR) and the Defense Acquisition Regulation (DAR) contained different criteria for making a total small business set-aside determination.

The DAR provided that if "...there is a reasonable expectation that (i) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (ii) awards will be made at reasonable prices..." a set-aside shall be made. (Emphasis added)

The FPR provided that "...there must be a reasonable expectation that bids or proposals will be obtained from a sufficient number of responsible concerns, organizations, and individuals so that awards will be made at reasonable prices." (Emphasis added)

When the small business section of the FAR was first published for public comment (July 1982), it contained the FPR "sufficient number" standard. Comments received supported a change to the DAR "rule of two" standard. Accordingly, when the final version of the FAR was published on April 1, 1984, it contained the "rule of two" standard.

In July 1984, following the issuance of the FAR, the Competition in Contracting Act of 1984 (CICA) was passed by Congress and signed into law by the President. The CICA contained the following requirement (Sec. 2732):

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:

> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

On February 21, 1986, OFPP submitted a proposed regulation to the Department of Defense, General Services Administration, and the National Aeronautics and Space Administration, and directed that it be published in the Federal Register for a 30-day comment period. The purpose of the regulation was to replace the "rule of two" criteria now in the FAR with the "sufficient number" criteria specified in the above provision of the Competition in Contracting Act. On March 29, 1986, the Deputy Assistant Secretary of Defense for Procurement advised OFPP that DOD, GSA, and NASA had concluded that "...since you have been the proponent of the change, it would be preferable for you to publish the policy directly." Accordingly, pursuant to the authorities granted in Section 6 of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. 401, et seq.), notice is hereby given that DOD, GSA, and NASA have failed to issue regulations in a timely manner and it is OFPP's intent to prescribe the following proposed regulation in the FAR after due consideration of all comments received in response hereto.

B. Regulatory Flexibility Act: The proposed revision of FAR Parts 6 and 19 is not expected to have a significant impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601, et seq.).

Adoption of the "sufficient number/lowest reasonable cost" formula should not reduce the number of small business set-asides. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Small Business Act. The regulations will still continue to require that contracting officers review acquisitions to determine if they can be set-aside and will still provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Contracting officials will continue to evaluate planned procurements in the same manner under the proposed regulations as they do under the current system. They will still evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will also continue to review the purchase history of the item or service to determine if it has been previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DOD's utilization of the "rule of two" commenced only about 5 years before the FAR.

Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond than large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (P.L. 98-369, the Competition in Contracting Act of 1984, and P.L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business would be substantially lower than that proposed by small business would a set-aside be cancelled. This is the case under current regulations as well.

C. Paperwork Reduction Act: The Paperwork Reduction Act (Pub. L. 96-511) does not apply because the proposed changes to FAR Parts 6 and 19 do not impose any additional reporting or recordkeeping requirements or collection of information from offerors, contractors, or members of the public which require the approval of OMB under 44 U.S.C. 3501, et seq.

PROPOSED RULE:

FEDERAL ACQUISITION REGULATION
PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 -- SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 -- Set-Asides for Small Business

Section 19.501-General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 -- SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

COMMENTS: All interested parties are invited to comment on this proposed regulation change. Comments should be forwarded to William S. Coleman, Jr., Office of Federal Procurement Policy, OMB, 726 Jackson Place, N.W., Washington, DC 20503 on or before July 1, 1986. Mr. Maraist may be contacted by phone on (202) 395-3501.

David F. Baker
Acting Administrator

Dated: ______________

THE SECRETARY OF DEFENSE
WASHINGTON, THE DISTRICT OF COLUMBIA

APR 10 [illegible] 56
6 APR 1986

Honorable James C. Miller, III
Director, Office of Management
and Budget
Washington, D.C. 20503

Dear Jim:

I am concerned about the consequences of a change to the threshold for small business set-asides that the Office of Federal Procurement Policy (OFPP) proposes to make in the Federal Acquisition Regulation.

The Department of Defense operates a significant small business program, not only because of the statutory provisions concerning small business, but because of the vital role played by small business in our defense industrial base. Key to the success of this effort are small business set-asides. The Federal Acquisition Regulation now permits such a set aside if the competitive base consists of two or more responsible small business concerns and the contracting officer determines that awards will be at reasonable prices. OFPP proposes to eliminate this "rule of two or more," and substitute as the numerical trigger for such set-asides the indefinite standard that there must be a "sufficient number of small business concerns" to fulfill the government's requirements at the "lowest reasonable cost." These criteria, coupled with the determinations required of the contracting officer, are likely to significantly impair the ability to make set-asides.

Congress has established the policy of ensuring that a fair share of our contracts are awarded to small business firms. The Small Business Act also provides for the Administrator of the Small Business Administration to establish annual goals for each Department to attain in awarding contracts to small business concerns. The only way a purchasing activity can assure that small business concerns receive any awards is through the set aside procedures. The "rule of two or more" provides an effective means for determining when a particular award should be set aside for small business. Specifing a definite number of bids as a set aside trigger is far more effective than an indefinite standard such as a "sufficient number."

The issue therefore comes down to a simple one. If purchasing agencies are to have the responsibility for assuring that a proportion of their awards go to small business with the attendant goals and evaluations of performance against the goals, then a set aside program coupled with a workable triggering device such as the "rule of two or more" is the only way of assuring that sizeable small business goals will be met. The "rule of two or more" can be eliminated or a less effective triggering device substituted only if at the same time the purchasing agencies are relieved of the responsibility of assuring that a proportion of their awards will go to small business. The "rule of two or more" issue cannot be decided without deciding the real effect of such a decision. To ignore the effect would mean that year after year the purchasing agencies would be excoriated before Congressional committees and in other fora for failing to meet small business goals. There would be further erosion in confidence in the government's purchasing system and continued dissention between the small business committees in Congress and the executive branch.

Accordingly, I would appreciate your taking a personal interest in this issue, and that the OFPP reconsider the directive regarding the "rule of two or more."

Sincerely,

Honorable Jack Brooks
Chairman, Government Operations Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In my March 5, 1986 reply to your letter concerning the Small Business Set-Aside provisions in the FAR (Rule of Two) I told you that we had notified the three procurement regulatory agencies that they must publish for comment a proposed rule revoking the rule of two. A copy of our February 21, 1986 letter to DOD, GSA and NASA is enclosed for your information. It provides notice under the provisions of OFPP Policy Letter 85-1 that, within 30 days of the date of the letter, the proposed regulations included therein must be published for a 30-day comment period.

After the expiration of the 30 day period we received the enclosed letter from Eleanor Spector, Deputy Assistant Secretary of Defense for Procurement, stating, in effect, that DOD, GSA and NASA would not publish the required regulatory change.

In view of the interest you have expressed on this issue I wanted to make you aware of these developments.~~, and I would be interested in your analysis or comments.~~

Sincerely,

Joseph R. Wright, Jr.
Deputy Director

Enclosures

cc:
DO Records
Deputy Director
LA
Mr. Maraist
OFPP:PD File/Chron/Read

OFPP:WMaraist/3/27/86:bfh

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 24 1986

MEMORANDUM FOR JOSEPH WRIGHT, JR.

FROM: David
David F. Baker

SUBJECT: Rule of Two

This will provide background information for your meeting with the deputies of DoD, GSA and NASA, which I understand that Amanda is setting up (in accordance with your instructions) for tomorrow, Tuesday, March 25th.

o On February 21st, we instructed the three procurement regulatory agencies to issue for comment within 30 days a proposed regulation that would replace the "rule of two" with the "sufficient number" formula - for use by contracting officers in making small business set-aside determinations. (Our February 21st instruction is attached at Tab A.) Today was the deadline for the agencies to publish the instruction for comment.

o Last Friday, I was contacted by Eleanor Spector - the head of DoD's procurement policy office - who said that the three agencies had concluded that they would not comply with our instruction. She said that this noncompliance was not due to their opposition to the substance of the regulatory change - but to the fact that we had not followed the specific requirements of the OFPP Policy Letter 85-1 (which sets out the procedures for OFPP's involvement in the regulatory process.)

o She also said that she understands that DoD's small business advocate had prepared a letter for Weinberger's signature to Jim Miller outlining DoD's substantive opposition to the proposed policy change, and asking that it be withdrawn. The important point that I garnered from Spector's call is that the political level in the agencies has not yet grappled with this issue, only the professional procurement people. So there still should be time to influence Will Taft (DoD), Paul Trause (GSA) and Bill Graham (NASA). (A more complete account of my conversation with E. Spector is attached at Tab B).

o The reaction, incidentally, to our February 21st instruction has been fairly muted. Predictably, the House Small Business Committee is upset with the decision (See Tab C) and has begun to orchestrate opposition in the small business community to our proposed change. There have been multiple Congressional and press inquiries regarding our action - but our responses to those questions have been generally well received. (Enclosed at Tab D are questions and answers, jointly developed with Jack Carley's staff, that describe the purpose of our February 21st instruction - and its likely effects. I suggest you may wish to read through these fairly carefully prior to your meeting with the three deputies.)

- The principal points which need to be made to the agency deputies, I believe, are these:

  (1) Our instruction to the agencies is clearly in accordance with, and required by, the Competition in Contracting Act of 1984 - which explicitly requires that the "sufficient number" formula be adopted. (The fact that we did not follow all the procedural requirements of our own Policy Letter is irrelevant and simply serves as a convenient excuse for the agencies not to act and, thus, avoid the heat generated by the small business community.)

  (2) The "sufficient number" formula is not new. A variation of it was used by the civil agencies prior to issuance of the FAR for many years - without any obvious deleterious effects on the small business set-aside program.

  (3) We are convinced that the effect of our proposed change will be minimal in terms of reducing the actual number of procurements set-aside for small businesses. Contracting officers simply will have a bit more discretion in making those set-aside decisions.

We will be pleased to discuss this matters further with you at your convenience.

Attachments

c: J. Carley
C. Dineen
C. Crawford

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND
LOGISTICS

2[illegible] MAR 1986

Mr. David F. Baker
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Room 9001
New Executive Office Building
Washington, DC 20503

Dear Mr. Baker:

In response to your request, this confirms my telephone call to you on March 21, 1986, regarding publishing your proposed change to the "rule of two" in the Federal Register. As I stated, we are concerned about Office of Federal Procurement Policy (OPFF) not following the agreement that we had worked out as set forth in OFPP policy letter 85-1 dated August 19, 1985.

However, this is not the underlying reason for my statement to you that we prefer OFPP publish the proposed change to the "rule of two." It is clear that the proposed change will be controversial. Were we to publish the change, we anticipate receiving a number of objections and requests for justification for the change from small business supporters in the Congress. After discussing this with my colleagues in GSA and NASA, we concluded that, since you have been the proponent of the change, it would be preferable for you to publish the policy directly. Of course we would assist you in this where we could.

Sincerely,

Eleanor Spector

Eleanor R. Spector
Deputy Assistant Secretary of
Defense for Procurement

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 21 1986

MEMORANDUM FOR RECORD

FROM: David F. Baker, Acting Administrator

SUBJECT: Regulatory Agency Response: Rule-of-Two

I was contacted today by Eleanor Spector (DoD's Deputy Assistant Secretary for Acquisition) at 1:20 p.m. regarding the procurement regulatory agencies' response to our February 21st instruction regarding replacement of the rule-of-two by the "sufficient number" formula. In the conference call, Ms. Spector indicated that she was in the company of Patricia Szervo (GSA's Associate Administrator for Acquisition Policy), Dennis Trosch (DoD General Counsel), and Larry Rizzi (FAR Executive Secretariat).

Ms. Spector informed me that the agencies had concluded that they would not comply with our February 21st instruction because the instruction did not reflect the process delineated in OMB Policy Letter 85-1. Specifically, she read the sentence from paragraph 7 that states, "... When the Administrator considers that a particular OFPP FAR change is not being resolved in a timely manner, the Administrator, after consultation with DoD, GSA and NASA, shall give notice and specify a time in which a decision must be reached regarding issuance of regulations." Ms. Spector pointed out that there had been no consultation or indication by OFPP of our disagreement with the agencies' view, or any indication of what constituted timeliness regarding the reaching of a decision on this issue -- and that, therefore, the OFPP instruction was contrary to the process which had been set up for this purpose.

I explained that while our instruction may not comply fully with the letter of 85-1, it was, nonetheless, a valid exercise of OFPP authority and reflected the Administration's desires with regard to the rule-of-two matter. And, while we would be disappointed if the agencies chose not to comply with our instruction, we would take whatever action was appropriate to implement the Administration's wishes.

Prior to concluding the conversation, Ms. Spector also volunteered the information that DoD's SADBU representative was preparing a letter for the Secretary's signature to the Director of OMB taking issue with the substance of the policy and pointing out its possible deleterious effects on small business. She again emphasized that while she did not personally question the Administration's right to issue the policy or the substance of the policy, she did question the form in which we did issue the instruction.

Upon reflection, I called Ms. Spector back to request that the substance of the preceeding conversation be provided to us officially and in writing. She said she would do so. She also said this decision had been cleared with L. Hopkins of NASA prior to her calling me.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 14, 1986

MEMORANDUM

TO: Bud Maraist

FROM: Diane Weinstein DW

SUBJECT: Sorg "Rule of Two" Letter

I propose you revise the first two paragraphs of the Sorg letter and add a third paragraph, along the following lines:

"I have been requested to respond to your letter of February 24, 1986 to President Reagan on the "rule of two" in small business set-aside procurement regulations.

You were correct in assuming that our interest in promoting the expansion of opportunities for small business has not diminished. However, your assumption that the replacement of the current "rule of two" in the 1984 Federal Acquisition Regulation (FAR) with a "sufficient number" standard will seriously impair opportunities for small companies to continue to do business with the Federal Government is not correct. In fact, prior to the FAR, civilian agencies used the sufficient number standard, as did the Department of Defense up until five years before the FAR.

The new rule will merely help ensure that procurements are not automatically set aside only because there is some likelihood that two small businesses will submit bids, and without regard to whether two such bidders will provide sufficient competition to result in an award that is within the "lowest reasonable cost" range for that type of contract.

x x x "

c: Jack Carley

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MAJORITY—225-5051
MINORITY—225-5074

✓ [illegible]
OFPP

MAR 17 1986

MAR 12 [illegible] 5: 28

March 10, 1986

To [illegible]
F/F.6

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

Thank you for your letter of March 5, 1986, notifying the Committee of OMB's decision to revoke the "Rule of Two". As you correctly note in your letter, the Competition in Contracting Act of 1984 (CICA) establishes new competition standards which require agencies to obtain a sufficient number of bids to ensure that the government receives the lowest reasonable cost.

I congratulate you on your decision to require the procuring agencies to modify the Federal Acquisition Regulation (FAR) to conform to the requirements of CICA. I believe that this step will not only reduce the cost of the government's purchases, but will in the long run open up a greater share of the Federal market to small businesses.

With best wishes, I am

Sincerely,

Jack Brooks

JACK BROOKS
Chairman

~~1) [illegible]~~
~~2) cc to Cooley~~

Official file - OFPP/PL&L
PL&L Chron
DO Records - OMB Control #22058
Director's Chron
Legislative Affairs
General Counsel
Mr. Baker
Mrs. Weinstein
OFPP Reading File (2)
Mr. Coleman's Chron

MAR 0 5 1986

Honorable Jack Brooks
Chairman, Committee on
Government Operations
U. S. House of Representatives
Washington, DC 20515

GC:DWeinstein 2/10/86
Edited:WSColeman:tjah 2/21/86

Identical letter sent to:
Honorable Frank Horton
Ranking Minority Member

Dear Congressman Brooks:

This is in reply to your letter of December 20, 1985, on the Total Set-Aside Provisions (TSAP) or "rule of two" contained in the Federal Acquisition Regulation (FAR) 19.502-2.

The TSAP currently provide that an acquisition shall be set aside for exclusive small business participation if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable prices." (Emphasis added.)

As a result of public concern that FAR adoption of the current provision was done without sufficient opportunity for public comment, the Office of Federal Procurement Policy (OFPP), on October 12, 1984, solicited the views of all interested persons on the "rule of two." More than 200 comments were received, of which approximately 65 percent opposed the provision.

Since then, as you note, the continuing validity of the "rule of two" was brought into question by the Competition in Contracting Act (CICA), which established competition principles based on the standard of "a sufficient number" of bids to result in the "lowest reasonable cost" to the Government.

After reviewing the legislative history of CICA and the comments solicited by the 1984 notice, OFPP has determined that the decision to set-aside an acquisition which exceeds $25,000 for exclusive participation by small business must be based upon the standard of competition established therein. Accordingly, we have notified the three procurement agencies that they must publish for comment a proposed rule revoking the rule of two. Such publication must occur within 30 days to be considered "timely" and avoid OFPP's directly exercising its independent statutory authority to prescribe this procurement regulation.

We trust this satisfactorily responds to your letter.

Sincerely,

Joe Wright

Joseph R. Wright, Jr.
Deputy Director

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Congress of the United States
House of Representatives
COMMITTEE ON SMALL BUSINESS
2361 Rayburn House Office Building
Washington, DC 20515

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CHRISTINE A. RUSSELL, MINORITY STAFF
DIRECTOR

MAJORITY—225-5821
MINORITY—225-4038

AREA CODE 202

March 4, 1986

Honorable Caspar W. Weinberger
Secretary
Department of Defense
The Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

This Committee has received a copy of a February 21, 1986 memorandum authored by David F. Baker, Acting Administrator of the Office of Federal Procurement Policy (OFPP), and addressed to the Secretary of Defense and the Administrators of the National Aeronautics and Space Administration (NASA) and the General Services Administration (GSA). This memorandum purports to exercise OFPP's authority pursuant to 41 U.S.C. section 405, as implemented by OFPP Letter 85-1. The subject of the memorandum is the "Small Business Set-Aside Determination Provisions of FAR."

We have reviewed the memorandum and, for the reasons stated below, do not believe it was issued "with due regard for applicable laws and the program activities of the executive agencies" (41 U.S.C. section 405(a)). Accordingly, we recommend that DoD, NASA, and GSA delay any requested publication until the issue of OFPP compliance with the statute is resolved by the President.

OFPP claims that the subject memorandum is required by section 2733 of the Competition in Contracting Act of 1984 (CICA). That provision amended section 16(1) of the OFPP Act to read as follows:

> "To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> > (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

Reading this statutory provision OFPP has concluded that:

(1) the so-called "rule of two" found in section 19.502 of the FAR should be repealed;

(2) a set-aside cannot take place unless the contracting officer demonstrates that a sufficient number of responsible small business concerns "will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost ...";

(3) a class set-aside cannot take place unless the contracting officer makes a written determination that the demonstration referred to in (2) "can be achieved on each procurement in that class, evaluating in detail ... quality, timeliness and cost factors"; and

(4) a repetitive set-aside cannot take place unless the contracting officer makes a written determination reaffirming that small business will submit the lowest reasonable cost.

OFPP's extreme interpretation is in contradiction with the clear meaning of relevant provisions of the CICA.

As you know, CICA amended, among other things, both the Federal Property and Administrative Services Act (FPASA) and, what is commonly referred to as the Armed Services Procurement Act (ASPA). For the sake of this discussion, we shall refer only to sections of the FPASA since CICA amends both statutes with identical provisions in the area here relevant.

Section 303(a) of FPASA generally requires that agencies obtain full and open competition through the use of competitive procedures. Subsection (b) of this same section, as amended by P.L. 98-577 (October 30, 1984), authorizes agencies to use competitive procedures but to exclude a specific source or, in the case of small business set-asides, to exclude all sources other than small business concerns.

Section 309(b) of FPASA, as amended by P.L. 98-577, defines competitive procedures as including small business set-asides "as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete."

Reading sections 303 and 309 together, it is clear that small business set-asides are to be deemed as full and open competition using competitive procedures provided that the buying agency does not limit the number of eligible small businesses that may submit an offer in response to a set-aside solicitation.

The provision cited by OFPP as requiring its proposed rule change (section 2733 of CICA, 42 U.S.C. section 414(1)), is a direction to Federal agency heads that, when implementing the FAR, they not adopt internal policies, procedures and practices that would unnecessarily restrict the number of otherwise eligible sources that could compete for the award. It is our impression that such unnecessary inhibitors to full and open competition may, in particular circumstances, include bonding requirements, restrictive specifications, geographic limitations, directed subcontracting sources, and other definitive elements of responsibility not justifiable in

light of the particular agency need in question. Such restrictions would, of course, militate against the use of full and open competition and its concomitant benefit of lowering costs. Our interpretation is fully consistent with sections 303 and 309 of the FPASA which preclude an agency from limiting the number of eligible small businesses that may compete for a set-aside. Indeed, if such a limitation would occur, that procurement would no longer be deemed full and open competition.

The "rule of two" has nothing whatsoever to do with a limitation on the number of eligible competing sources. The rule is applied prospectively (before the requirement is synopsized) by a contracting officer to determine whether a procurement should be set-aside -- not whether an eligible small business should be precluded from submitting an offer.

Aside from the fact that the proposed regulation is not required by CICA, the regulation, if adopted, would also have a detrimental effect on the Federal acquisition process. By way of illustration, consider the following:

(1) How can a contracting officer equitably administer a "lowest reasonable cost" standard when the particular acquisition in question may be awarded under source selection criteria that subordinate cost to technical merit?

(2) Can the "lowest reasonable cost" standard ever be met if a large business indicates an interest in submitting an offer?

(3) In those relatively few instances when the contracting officer can demonstrate that only small business will submit proposals and, therefore, that the "lowest reasonable cost" test will be satisfied, are not set-asides rendered meaningless since the awards will be made to small business regardless of the procurement strategy used? Is it reasonable for OFPP to assume that Congress intended to render the set-aside authority a practical nullity through the strained construction of a statutory provision that does not even mention set-asides?

(4) Why does CICA require "a reasonable expectation of receiving more than one sealed bid" as the standard for a sealed bid procurement (section 2711(a)(1)), but, as interpreted by OFPP, require a more stringent standard for small business set-asides?

(5) How can an agency expect its program activities to expand competition and the mobilization base (see section 15(a) of the Small Business Act) if it cannot limit the concentration of contracts through the use of set-asides?

(6) Would adoption of the regulation set a precedent that the Administrator of OFPP has the authority to implement -- through memoranda -- the responsibilities reserved to agency heads under 41 U.S.C. section 414?

We fully understand that certain buying agencies have experienced difficulties with set-asides in some industrial areas because of faulty size standards adopted by the Small Business Administration (SBA). However, we believe the solution to that problem is size standard reform, not the effective elimination of set-asides.

For the reasons cited above, we again urge that publication of the proposal be indefinitely delayed so that DoD, NASA, and GSA have an opportunity to present their positions on these most important issues directly to the President.

If you should have any questions regarding this letter, please have a member of your staff contact our Committee's Legislative Counsel, Tom Trimboli, at 225-4351.

Sincerely,

Joseph P Addabbo
Joseph P. Addabbo, M.C.

Parren J Mitchell
Parren J. Mitchell
Chairman

Berkley Bedell
Berkley Bedell, M.C.

Nicholas Mavroules
Chairman, Subcommittee on General
Oversight and the Economy

PJM:ttf

cc: Norma Leftwich, Director
Office of Small & Disadvantaged Business
Utilization, Department of Defense

John Wynn, Director
Office of Small & Disadvantaged Business
Utilization, General Services Administration

Eugene Rosen, Director
Office of Small & Disadvantaged Business
Utilization, National Aeronautics and
Space Administration

NEWS from:
COMMITTEE ON SMALL BUSINESS
Parren J. Mitchell, Chairman
U.S. House of Representatives, Washington, D.C. 20515

SUBCOMMITTEE CHAIRMEN
PARREN J. MITCHELL CHARLES W. STENHOLM
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FOR RELEASE: March 3, 1986

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ADMINISTRATION SEEKS TO END SMALL BUSINESS SET ASIDES

An Office of Management and Budget (OMB) proposal to restrict Federal set-asides will cost small business billions of dollars in contract awards each year, Rep. Parren J. Mitchell (D-Md.), Chairman of the House Committee on Small Business, charged today.

Under the OMB proposal, Federal procurement regulations would require contracting officers to demonstrate before a contract is advertised for bidding that small business can provide the "lowest reasonable cost."

Mitchell said, "This is an impossible standard to meet since it gives any big business the opportunity to veto a set-aside merely by saying that it is interested in submitting an offer." Mitchell characterized the OMB proposal as a thinly disguised effort to increase Federal contract awards to big business, which receives over 80 percent of the Federal procurement dollar and represents only one percent of all U.S. businesses.

Small business depends on set-asides for half the volume of business it does with the Federal Government, benefiting from the so-called "rule of-two," under which the contracting officer reserves for small business set aside those contracts expected to generate offers from at least two responsible small businesses offering reasonable prices.

Elimination of the "rule of two" would jeopardize the capital base of thousands of small businesses and aid further concentration of Federal procurement opportunities for big corporations.

Small business received $15.6 billion in set-aside contracts from the Federal Government in fiscal year 1984. Nearly one-half of all prime contracts to small businesses are awarded under the set-aside program.

Purportedly, OMB's directive is based on a little known provision of the Competition in Contracting Act (July 1984), which requires agencies to establish "policies, procedures, and practices," to assure receipt of a sufficient number of bids in order to obtain the "lowest reasonable cost."

"This provision was clearly intended to prevent agencies from adopting contract requirements that would unreasonably limit the number of businesses that could submit an offer," Mitchell said.

"The rule of two," Mitchell continued, "has absolutely nothing to do with a limitation on the number of eligible competing sources."

Over the last few years both the Congress and the White House have been pressured to reduce set-aside eligibility criteria (size standards) for a number of industries in which nearly all contracts are reserved for small businesses. A bill (H.R. 1178) proposing to do that was defeated by the House Committee on Small Business on February 25, by a vote of 24 to 20.

The Inspector General is investigating a charge by Mitchell that SBA engaged in illegal lobbying against the measure.

# # #

National Small Business Association
"The Voice of Small Business"
Founded 1937

SPEAKING OF SMALL BUSINESS

"RULING" OUT SMALL BUSINESS

If you are one of the thousands of small firms doing business with the federal government, you are about to get sandbagged by the OFPP.

You've never heard of OFPP? It's the Office of Federal Procurement Policy, a low-profile, highly influential part of the bureaucracy that sets the rules by which the government contracting game is played.

The OFPP is part of the Office of Management and Budget and it wants to repeal the "rule of two". Getting rid of government regulations normally is a sound idea. In this instance, however, it's one of the worst ideas the bureaucracy has come up with. It ranks with the "contemporaneous" recordkeeping rule IRS issued last year on the use of business vehicles.

The "rule of two" says that when there are at least two responsible small firms bidding on a contract and the government can expect to pay a reasonable price, the contract must be "set aside" for bidding by small firms only. It does not mean that bidding is limited to two small firms. It does mean that big businesses cannot bid.

The rule has been in use by some agencies since 1964 and by all federal agencies since 1984.

Why is it so important? It insures that a small business is going to get the contract and the taxpayers are going to pay a reasonable price. If the figures the bureaucracy gives us are correct, small business gets about $30 billion a year in federal prime contracts. Nearly half of that,

$15.6 billion, came as the result of the "set-aside" program in FY 1984.

If the rule is repealed, it could cut small business' already meager take of the federal procurement dollar in half! Big businesses which represent only one percent of all businesses in the nation, already get 80% of the contract dollars. They stand to get even more if the "rule of two" is repealed.

The OFPP says it is complying with a provision of the Competition in Contracting Act of 1984. That section directs agencies to "increase the use of full and open competition. . ." by adopting policies, procedures and practices that assure the agency receives a sufficient number (emphasis supplied) of sealed bids.

The manner in which the OFPP has interpreted the Act, in effect, directs contracting officers to justify in writing, setting aside contracts for bidding by small firms only. More important, it in effect offers big businesses which already have complained that competition from small firms is "eroding" their sale of spare parts, a chance to have a "set-aside" rejected merely by indicating they might bid.

Getting the best price has not necessarily been contracting officers prime consideration. Remember $400 hammers and $640 toilet seats? Their main objective is to get the item delivered according to specificiations and on time. It is not reasonable to expect them to jeopardize that objective by making detailed surveys and written determinations prescribed in the proposed rule change.

The OFPP says its proposal complies with the law. Congress says OFPP is misinterpreting the law. If all this has a familiar ring to it, it should. Congress last year directed IRS to change the rules on justifying the use of business vehicles ~~to~~ For tax purposes. IRS did. However what they issued hardly overcame what Congress objected to in the first place and Congress is again taking IRS to task.

It is no secret that the person originally designated to draft proposed legislation sent to Congress, often is the one who gets it back for interpretation once Congress passes the law. It's an easy way for the Executive Branch to circumvent Congressional directives it doesn't completely agree with.

Repealing the "rule of two" is a bad idea. It will rule thousands of small businesses out of the federal marketplace. It will destroy the "set-aside" program that provides nearly half of all the contracting dollars small firms get from the government. It will likely impair to a serious degree the capital base of thousands of small businesses and worse, it will jeopardize even further the competitive position of small business and increase the concentration of federal contracting in big corporations.

If you are affected by and concerned with this proposal, be on the lookout for an announcement of its being published for public comment. Send your comments to the Director of the Office of Management and Budget. You should also let your Senators and Congressman know how you feel. If you write to us, we'll make certain your comments are passed on to the appropriate Congressional Committees for their action.

The "rule of two" was and continues to be a good rule for small business.

(SPEAKING OF SMALL BUSINESS is published monthly by the National Small Business Association, a bi-partisan, non-profit organization of small business owners, 1155 15th St. NW, Seventh Floor, Washington, DC 20005.)

DRAFT F

NOVEMBER 1985

OFPP BULLETIN 85-1
FEDERAL ACQUISITION REGULATION
SET-ASIDE COMPETITION
ENHANCEMENT

TO: THE HEADS OF THE GENERAL SERVICES ADMINISTRATION, THE DEPARTMENT OF DEFENSE, AND THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

SUBJECT: Proposed Competitive Procedures to Assure Award of a Fair Proportion of Federal Contracts to Small Businesses: FAR 19.502-2 and 36.601.

1. Purpose. This OFPP Bulletin announces OFPP's intention to take appropriate steps to exercise its authority under Section 6(b) of the Office of Federal Procurement Policy Act (P.L. 93-400, as amended) to "prescribe Government-wide regulations ... which shall be followed by executive agencies" when the Department of Defense, the National Aeronautics and Space Administration and the General Services Administration are "unable to agree on or fail to issue [such] regulations ... in a timely manner." 41 U.S.C. 414(l) (Emphasis added). OFPP intends not to exercise this authority if these three FAR regulatory agencies or the two FAR Councils initiate their own procedures to issue regulations that would substantially accomplish the purposes of these proposed regulations within [30] days of the date hereof.

The regulations OFPP intends to prescribe are set forth below and are required to implement in the Federal Acquisition Regulation

(FAR) the specific requirement of the 1984 Competition in Contracting Act (CICA), P.L. 98-369,

2. Authority. The Office of Federal Procurement Policy Act, as amended. (41 U.S.C. 401 *et seq.*).

3. Background.

a. Under Federal law, Federal agencies have dual obligations -- of enhancing competition but also promoting opportunities for small businesses to supply the products and services the Government needs. The programs to set aside certain procurements for small businesses, authorized by the Small Business Act, 15 U.S.C. 644, were intended to promote small business competition by giving small firms experience and the opportunities to enter a new market. Their purpose is not to create a class of firms perpetually dependent on special subsidies, irrespective of improvements in their financial situation and growth capacity, nor to require the Government to enter into contracts that are unreasonably costly to the Government. The Government's interest in applying competitive principles both in the decision whether to set aside a class of contracts, and, in selecting among responsible firms within these special preference programs has been reiterated in recent legislation, such as the Competition in Contracting Act (Public Law 98-369); the 1985 Military Construction Authorization Act (Public Law 98-407); the Defense Procurement Reform Act (Public Law 98-525) and the Small Business Procurement and Competition Enhancement Act (Public Law 98-577).

b. Under the current "Rule of Two" standard in the FAR, an agency must set aside a procurement or class of procurements for small businesses if there is a reasonable expectation of at least two offers from small businesses. There is no statutory mandate

to use this "Rule of Two," or any other arbitrary numerical standard, in measuring competition among small businesses. Prior to the FAR, civilian agencies utilized a "sufficient number" standard for this purpose. No public policy is served by permitting competition to be cut off merely because there is a prospect of receiving only two bids. The Rule of Two may provide administrative simplicity and statistical gains, but only at the potential expense of sufficient competition to result in the lowest reasonable cost to the Government.

c. Congress' intent to require full and open competition in set-aside situations, and return to a "sufficient number" standard for measuring the expectation of competition in the initial set-aside determination, is evident in the CICA amendments to the OFPP Act. The CICA amendment to Section 16 of the OFPP Act, 41 U.S.C. 414, requires executive agencies to

> "increase the use of full and open competition in the procurement of property or services ... by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment clearly stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1~~[illegible]~~34. (Emphasis
> 4

added.)

There can be no doubt that this Amendment requires the elimination of the Rule of Two -- or any other per se rule -- in agency set-aside determinations.

d. The Competition in Contracting Act was signed into law on July 18, 1984. Almost a year has pased since Circular 84-5, was issued Jan. 11, 1985. Federal Acquisition CICA became effective on April 1, 1985, adding the Part 6 "Competition Requirements" for immediate implementaton to the FAR. The continuing failure of DoD, NASA and GSA to timely issue regulations amending the FAR to implement this competition requirement of CICA, nothwithstanding ample notice that such action was intended by Congress, makes it incumbent upon the Administrator of OFPP to prescribe such regulations, pursuant to his independent authority and responsibility under the OFPP Act.

4. Proposed Regulation. The proposed regulations would make the following amendments to the FAR:

a. FAR 6.101 is amended to add subsection (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

b. FAR 19.502-2 is amended to read:

The entire amount of an individual acquisition or class of acquisitions may be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the government requirements for the best available quality in goods or services on a timely basis at a fair and reasonable price, considering the nature of the property or services acquired. Compliance with the presumption of sufficiency will vary, taking into account the nature of the procurement and the size, character and complexisty of each contracting industry. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and pricing factors noted above.

c. FAR 19.501(g) is amended to read:

Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service (if not subject to the simplified small purchase procedures) shall be acquired by set-aside only after the contracting officer provides a written determination reaffirming the validity of the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each subsequent procurement in that class. (See also Part 19.501-1.)

d. Other Requirements.

In implementing these regulations each agency head shall designate the Advocate for Competition and designees at a comparable level in major component organizations to regularly review set-aside decisions to assure compliance with these regulations within the component organization and the agency.

OMB Responsibility and Contact Point. Address questions or inquiries regarding this Bulletin to ____________________, the Office of Management and Budget, Office of Federal Procurement Policy, 725 Jackson Place, N.W., Room 9001, Washington, D.C. 20503. Telephone number (202) 395-5802.

William Mathis
Administrator (Acting)

ROUTING AND TRANSMITTAL SLIP

Date 12/5/85

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DRAFT

NOVEMBER 1985

OFPP BULLETIN 85-1
FEDERAL ACQUISITION REGULATION
SET-ASIDE COMPETITION
ENHANCEMENT

TO: THE HEADS OF THE GENERAL SERVICES ADMINISTRATION, THE DEPARTMENT OF DEFENSE, AND THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

SUBJECT: Proposed Competitive Procedures to Assure Award of a Fair Proportion of Federal Contracts to Small Businesses: FAR 19.502-2 and 36.601.

1. Purpose. This OFPP Bulletin announces OFPP's intention to take appropriate steps to exercise its authority under Section 6(b) of the Office of Federal Procurement Policy Act (P.L. 93-400, as amended) to "prescribe Government-wide regulations ... which shall be followed by executive agencies" when the Department of Defense, the National Aeronautics and Space Administration and the General Services Administration are "unable to agree on or fail to issue [such] regulations ... in a timely manner." 41 U.S.C. 414(1) (Emphasis added). OFPP intends not to exercise this authority if these three FAR regulatory agencies or the two FAR Councils initiate their own procedures to issue regulations that would substantially accomplish the purposes of these proposed regulations within [30] days of the date hereof.

The regulations OFPP intends to prescribe are set forth below and are required to implement in the Federal Acquisition Regulation

(FAR) the specific requirement of the 1984 Competition in Contracting Act (CICA), P.L. 98-369,

2. Authority. The Office of Federal Procurement Policy Act, as amended. (41 U.S.C. 401 *et seq*.).

3. Background.

a. Under Federal law, Federal agencies have dual obligations -- of enhancing competition but also promoting opportunities for small businesses to supply the products and services the Government needs. The programs to set aside certain procurements for small businesses, authorized by the Small Business Act, 15 U.S.C. 644, were intended to promote small business competition by giving small firms experience and the opportunities to enter a new market. Their purpose is not to create a class of firms perpetually dependent on special subsidies, irrespective of improvements in their financial situation and growth capacity, nor to require the Government to enter into contracts that are unreasonably costly to the Government. The Government's interest in applying competitive principles both in the decision whether to set aside a class of contracts, and, in selecting among responsible firms within these special preference programs has been reiterated in recent legislation, such as the Competition in Contracting Act (Public Law 98-369); the 1985 Military Construction Authorization Act (Public Law 98-407); the Defense Procurement Reform Act (Public Law 98-525) and the Small Business Procurement and Competition Enhancement Act (Public Law 98-577).

b. Under the current "Rule of Two" standard in the FAR, an agency must set aside a procurement or class of procurements for small businesses if there is a reasonable expectation of at least two offers from small businesses. There is no statutory mandate

to use this "Rule of Two," or any other arbitrary numerical standard, in measuring competition among small businesses. Prior to the FAR, civilian agencies utilized a "sufficient number" standard for this purpose. No public policy is served by permitting competition to be cut off merely because there is a prospect of receiving only two bids. The Rule of Two may provide administrative simplicity and statistical gains, but only at the potential expense of sufficient competition to result in the lowest reasonable cost to the Government.

c. Congress' intent to require full and open competition in set-aside situations, and return to a "sufficient number" standard for measuring the expectation of competition in the initial set-aside determination, is evident in the CICA amendments to the OFPP Act. The CICA amendment to Section 16 of the OFPP Act, 41 U.S.C. 414, requires executive agencies to

> "increase the use of full and open competition in the procurement of property or services ... by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment clearly stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis

added.)

There can be no doubt that this Amendment requires the elimination of the Rule of Two -- or any other per se rule -- in agency set-aside determinations.

d. The Competition in Contracting Act was signed into law on July 18, 1984. Almost a year has passed since Circular 84-5, adding the Part 6 "Competition Requirements" for immediate implementaton to the FAR, was issued on Jan. 11, 1985. CICA became effective on April 1, 1985. The continuing failure of DoD, NASA and GSA to timely issue regulations amending the FAR to implement this competition requirement of CICA, nothwithstanding ample notice that such action was intended by Congress, makes it incumbent upon the Administrator of OFPP to prescribe such regulations, pursuant to his independent authority and responsibility under the OFPP Act.

4. Proposed Regulation. The proposed regulations would make the following amendments to the FAR:

a. FAR 6.101 is amended to add subsection (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

b. FAR 19.502-2 is amended to read:

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business--small purchase set-asides, may be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance, quality, and delivery schedules) at the lowest reasonable cost, considering the nature of the property or services acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

c. FAR 19.501(g) is amended to read:

Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by set-aside only after the contracting officer provides a written determination reaffirming the validity of the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each subsequent procurement in that class.

d. Other Requirements.

In implementing these regulations each agency head shall designate the Advocate for Competition and designees at a comparable level in major component organizations to regularly review set-aside decisions to assure compliance with these regulations within the component organization and the agency.

OMB Responsibility and Contact Point. Address questions or inquiries regarding this Bulletin to ___________________, the Office of Management and Budget, Office of Federal Procurement Policy, 725 Jackson Place, N.W., Room 9001, Washington, D.C. 20503. Telephone number (202) 395-5802.

William Mathis
Administrator (Acting)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 11 1986

MEMORANDUM FOR JACK CARLEY

FROM: David F. Baker

SUBJECT: Small Business Set-Asides

Opposition - principally from the House Small Business Committee and various small business lobbying groups - is beginning to build in response to my instruction of February 21st, regarding replacement of the "rule of two" regulation. (Enclosed are various press releases to this effect, for your information.) There have been and continue to be numerous press and Congressional staff inquiries as a result of the OFPP instruction.

To familiarize our public affairs and Congressional liaison staffs with this issue, we have prepared a series of questions and answers which provide the background, rationale and probable effects of our action. I would appreciate your review of the attached to assure that you and I are in consonance on all aspects of this issue before the material is distributed. To be most useful, I would prefer to provide these questions and answers to Ed Dale, Bryce Harlow and other affected or interested OMB staff by this coming Friday (March 14th).

Thanks for your help.

Attachments

cc: Diane Weinstein

in the Federal Acquisition Regulation (FAR)

any

QUESTIONS AND ANSWERS REGARDING SMALL BUSINESS SET-ASIDES

Q.1. What is the intended effect of the instruction to agencies to publish a proposed small business set-aside regulation, as issued by OFPP on February 21, 1986.

A.1. The notice is intended to initiate action to replace the current procurement regulation governing small business set-asides with one that ~~is in concert with~~ the Competition in Contracting Act of 1984 (CICA). The current regulation requires that contracting officers set-aside a procurement for exclusive small business participation where "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns, and (b) awards will be made at reasonable prices."

fully implement

(establishes rule of thumb,)

The proposed rule, based upon wording in the statute, requires that — in order to set-aside a procurement — contracting officers determine that the agency will receive a sufficient number of sealed bids or competitive proposals from responsible small business sources to fulfill the Government's requirements at the lowest reasonable cost. The three procurement regulatory agencies (DOD, GSA, and NASA) have been instructed to initiate the regulatory change by publishing the proposed regulation by March 23, 1986, for a 30-day period for public comment.

such as the rule of two and inst

The "sufficient number" standard is very familiar to procurement officers who employed it for years in the civilian agencies before the FAR in 1984.

Q.2. Will elimination of the "rule of two" end small business set-asides?

A.2. No. Contracting officials will evaluate planned procurements in the same manner under the proposed regulations as they do under the current system. They will evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will review the purchase history of the item or service to determine if it has been previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. The "sufficient number" standard has been utilized for many years in small business set-asides.

In fact the "rule of two"

In fact.

Prior to the FAR, civilian agencies did utilization of the "rule of two," only utilized the sufficient number standard.

Q.3. What is the Administration's position on preferential procurement programs, generally, and on small business set-asides, in particular?

A.3. The Administration has consistently expressed support for programs which promote the development and growth of small businesses. To illustrate: small business set-asides were supported as part of the Administration's Proposal for a Uniform Federal Procurement System submitted to the Congress in February 1982. The legislative proposal which was submitted to implement the proposal served as a basis for the competition provisions of the Competition in Contracting Act of 1984 (P.L. 98-369), which recognizes small business set-asides as instances of "full and open competition" limited to small business contractors. Moreover, the President signed a proclamation last month declaring a National Small Business Week.

years before the FAR

Q.4. If the "sufficient number/lowest reasonable cost" formula is implemented, what will be the effect upon the number of small business set-asides? (Some commenters have stated they will be reduced by 50%.) Shouldn't that be determined before such a regulation is adopted?

A.4. The legal effect of Section 2732 of the Competition in Contracting Act of 1984 imposes the "sufficient number/lowest reasonable cost" formula as a matter of law. The effect on the number of set-asides by adoption of this formula is not a matter which can alter adoption of the formula. Although the precise effect is impossible to calculate, as a practical matter, it does not appear that adoption of the formula will reduce the number of small business set-asides. There may be a temporary reduction until agency contracting personnel become familiar with the revised regulations. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Small Business Act. The regulations will continue to require that contracting officers review acquisitions to determine if they can be set-aside and provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Q.5. Will adoption of the "lowest reasonable cost" standard give any big business the opportunity to veto or set-aside merely by saying it is interested in submitting an offer?

A.5. No. Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond, with a lower reasonable cost, ~~from a cost standpoint~~, than ~~a~~ large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (P.L. 98-369, the Competition in Contracting Act of 1984, and P.L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where, it is determined that the price from a large business ~~is~~ would be substantially lower than that proposed by small businesses would a set-aside be cancelled. The GAO has previously upheld cancellation of a set-aside procurement when information bids from large businesses indicated that the small business' price ~~is~~ was unreasonable.

Q.6. How could any contracting officer be assured of having the "lowest reasonable cost" if he does not let large businesses bid?

A.6. The answer must be stated and understood in terms of the law that established the requirement. The CICA requires "full and open competition," which means all firms, large and small, must be allowed to compete. ~~It also requires "a sufficient number" of competitors to fulfill requirements at the~~

This is the case under current law as well.

However, a procurement cannot initially be set aside

intended not to preclude

3

~~"lowest reasonable cost."~~ ~~Such~~ This provisions would appear to negate small business set-asides. However, CICA very clearly ~~exempted~~ small busines set-asides ~~from any encumbrance by the provisions of the Act.~~ Thus, Full and open competition was stated in the Act to exist when the competition is conducted solely among small businesses. ~~Likewise, lowest reasonable cost must be read to mean the lowest reasonable cost among small businesses. Otherwise the expressed intent of Congress to retain the small business set-aside program would be violated.~~

Q.7. Under the proposed rule, if a large business comes forward and shows the contracting officer, through catalogue prices or otherwise, that its price ~~is~~ would be substantially lower than the prices ~~paid to~~ offered by small business, will the contracting officer not set-aside the procurement?

A.7. The procurement would probably possibly not be set-aside. However, it is important to know the reason. It is not because a large business expressed interest in the procurement. It is because the contracting officer must make awards at "reasonable" prices. If the information supplied by the large business merely showed that it would be competitive with a sufficient number of small businesses that, in themselves, assure competition, the procurement would be set-aside at. This response would also hold true ~~if asked with respect to~~ the "rule of two." This regulation also does not allow a bad business decision by the contracting officer. In addition to having "at least two" small businesses, the contracting officer must determine that the competition will result in reasonable prices. If confronted with the same information from the same large business (substantially lower price), the procurement would not be set-aside even under the "rule of two."

This is necessary to protect the Government ~~Government~~ paying unreasonable costs. The fear is that with ~~the~~ a rule of only two, contracting officers may fail to ascertain that there is a real likelihood of bids in the lowest reasonable cost range, but may automatically set-aside whenever two potential small business bidders can be identified.

The small business set aside program was never intended to force the Government into ~~pay~~ substantially higher costs.

Q.8. What will OFPP do if the three regulatory agencies fail to issue the regulation for comment by March 23, 1986? Will it issue a draft policy letter for comment?

A.8. If the regulatory agencies fail to issue Internal proposed regulations by March 23, 1986, OFPP ~~will attempt to discuss why such proposed regulations have not been issued. If it appears that proposed regulations are imminent (2 or 3 days), no action will be taken. If proposed regulations are not imminent, OFPP~~ will utilize its regulatory authority under the OFPP Act (41 USC 405) and, as outlined in OFPP Policy Letter 85-1, issue proposed regulations to be implemented in the Federal Acquisition Regulation for 30 days' public comment. We fully expect, however, that such action will not be necessary.

There was some limited discussion with the SBA prior to OFPP's decision to request the three agencies to issue the rule.

Q.9. Was this proposed regulation discussed, at least informally, with representatives of the small business community (i.e., SBA, SADBUs, appropriate Congressional staff) prior to issuance? If not, why not?

The rule has not yet been issued in final form. ~~[illegible]~~ Thus, Interested parties will have a full opportunity to

A.9. ~~There was no discussion with the small business community prior to issuance. It was not discussed because the proposed regulation results from a legal interpretation of the provisions of Section 2732 of the Competition in Contracting Act of 1984. The proposed regulation is, therefore, not considered a matter of policy wherein OFPP would discuss its proposal with~~

Many commenters noted that CICA, which was to become effective on April 1, 1985, evidenced Congress' concern with the continuing legality and appropriateness of noncompetitive procedures such as the rule of two in set-aside situations.

express their views

~~[illegible]~~ on the proposed rule

as they are now doing.

~~interested parties.~~ In this case, ~~interested parties may express their views~~ during the public comment period and, for that matter, ~~at the present~~ time.

Q.10 If the CICA is what caused OFPP to issue the proposed instruction, why did OFPP wait over 18 months to do so? Specifically, what triggered this action? before publication of the proposed rule.

A.10. After its initial review of the provisions of CICA, OFPP did not conclude that a revision of the regulations addressing small business set-asides was required by the statute. however, after its review that the rule of two had been included in the FAR without to publish for public comment In December 1984, Congressmen Jack Brooks and Frank Horton and Senators William Cohen and Carl Levin wrote to the regulatory agencies concerning the proposed FAR implementation of CICA. Among the matters which they pointed out was the fact that "rule of two," contained in FAR Part 19, was not appropriate in view of the language in Section 2732 of CICA regarding "sufficient number" and "lowest reasonable cost." They also ~~further~~ stated that ~~it~~ was their intent, as co-sponsors of the legislation, to eliminate the "rule of two." The regulatory agencies disagreed, in a response to the members in August 1985. The matter was raised again in December 1985, by a letter from Congressmen Jack Brooks and Frank Horton to Joseph Wright, Deputy Director of OMB, asserting their view that the "rule of two" was contrary to the CICA. ~~After a coordinated review by the OFPP and the General Counsel of OMB, it was concluded that the provisions of the CICA require that the~~ regulations ~~be revised as~~ substitute the "sufficient number/lowest reasonable cost" formula in CICA for the "at least two/reasonable price" formula.

proposed

After considering the comments on the October 1984 notice of comment and the provisions of CICA OFPP decided

Q.11. Does the proposed approach apply to 8(a) firms — and the process by which they are awarded contracts? If not, why not?

A.11. The proposed approach will not apply to firms which are awarded subcontracts under Section 8(a) of the Small Business Act. It should be noted that Section 8(a) of the Small Business Act authorizes the Small Business Administration to enter into direct contracts with Federal agencies to provide goods and services by subcontracting the actual performance to small business firms which have been accepted into the business development program established by the Act. The regulations and procedures for 8(a) contracts and subcontracts are separate and apart from those governing small business set-asides and are unaffected by the OFPP notice.

Only if ~~In the event that~~ a firm ~~which is included~~ in the 8(a) program ~~chooses to~~ seeks direct procurements independent of the program, it would be subject to the standard FAR provisions, including the set-aside regulations.

providing adequate public notice and opportunity for comment, OFPP published a Notice of Comment on Oct. 12 1984, 49 Fed. Reg. 40135.

DRAFT 12/5

DECEMBER
~~NOVEMBER~~ 1985

OFPP BULLETIN 85-1
FEDERAL ACQUISITION REGULATION
SET-ASIDE COMPETITION
ENHANCEMENT

TO: THE HEADS OF THE GENERAL SERVICES ADMINISTRATION, THE DEPARTMENT OF DEFENSE, AND THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

SUBJECT: Proposed Competitive Procedures to Assure Award of a Fair Proportion of Federal Contracts to Small Businesses: FAR 19.502-2 and 36.601.

1. *Purpose*. This OFPP Bulletin announces OFPP's intention to take appropriate steps to exercise its authority under Section 6(b) of the Office of Federal Procurement Policy Act (P.L. 93-400, as amended) to "prescribe Government-wide regulations ... which shall be followed by executive agencies" when the Department of Defense, the National Aeronautics and Space Administration and the General Services Administration are "unable to agree on *or fail to issue* [such] regulations ... in a timely manner." 41 U.S.C. 414(1) (Emphasis added). OFPP intends not to exercise this authority if these three FAR regulatory agencies or the two FAR Councils initiate their own procedures to issue regulations that would substantially accomplish the purposes of these proposed regulations within [30] days of the date hereof.

The regulations OFPP intends to prescribe are set forth below and are required to implement in the Federal Acquisition Regulation

(FAR) the specific requirement of the 1984 Competition in Contracting Act (CICA), P.L. 98-369,

2. Authority. The Office of Federal Procurement Policy Act, as amended. (41 U.S.C. 401 *et seq.*).

3. Background.

a. Under Federal law, Federal agencies have dual obligations -- of enhancing competition but also promoting opportunities for small businesses to supply the products and services the Government needs. The programs to set aside certain procurements for small businesses, authorized by the Small Business Act, 15 U.S.C. 644, were intended to promote small business competition by giving small firms experience and the opportunities to enter a new market. Their purpose is not to create a class of firms perpetually dependent on special subsidies, irrespective of improvements in their financial situation and growth capacity, nor to require the Government to enter into contracts that are unreasonably costly to the Government. The Government's interest in applying competitive principles both in the decision whether to set aside a class of contracts, and, in selecting among responsible firms within these special preference programs has been reiterated in recent legislation, such as the Competition in Contracting Act (Public Law 98-369); the 1985 Military Construction Authorization Act (Public Law 98-407); the Defense Procurement Reform Act (Public Law 98-525) and the Small Business Procurement and Competition Enhancement Act (Public Law 98-577).

b. Under the current "Rule of Two" standard in the FAR, an agency must set aside a procurement or class of procurements for small businesses if there is a reasonable expectation of at least two offers from small businesses. There is no statutory mandate

to use this "Rule of Two," or any other arbitrary numerical standard, in measuring competition among small businesses. Prior to the FAR, civilian agencies utilized a "sufficient number" standard for this purpose. No public policy is served by permitting competition to be cut off merely because there is a prospect of receiving only two bids. The Rule of Two may provide administrative simplicity and statistical gains, but only at the potential expense of sufficient competition to result in the lowest reasonable cost to the Government.

c. Congress' intent to require full and open competition in set-aside situations, and return to a "sufficient number" standard for measuring the expectation of competition in the initial set-aside determination, is evident in the CICA amendments to the OFPP Act. The CICA amendment to Section 16 of the OFPP Act, 41 U.S.C. 414, requires executive agencies to

> "increase the use of full and open competition in the procurement of property or services ... by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment clearly stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1934. (Emphasis

added.)

There can be no doubt that this Amendment requires the elimination of the Rule of Two -- or any other per se rule -- in agency set-aside determinations.

d. The Competition in Contracting Act was signed into law on July 18, 1984. Almost a year has passed since Circular 84-5, adding the Part 6 "Competition Requirements" for immediate implementaton to the FAR, was issued on Jan. 11, 1985. CICA became effective on April 1, 1985. The continuing failure of DoD, NASA and GSA to timely issue regulations amending the FAR to implement this competition requirement of CICA, nothwithstanding ample notice that such action was intended by Congress, makes it incumbent upon the Administrator of OFPP to prescribe such regulations, pursuant to his independent authority and responsibility under the OFPP Act.

4. Proposed Regulation. The proposed regulations would make the following amendments to the FAR:

a. FAR 6.101 is amended to add subsection (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

b. FAR 19.502-2 is amended to read:

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, may be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance, quality, and delivery schedules) at the lowest reasonable cost, considering the nature of the property or services acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

c. FAR 19.501(g) is amended to read:

Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by set-aside only after the contracting officer provides a written determination reaffirming the validity of the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each subsequent procurement in that class.

d. Other Requirements.

In implementing these regulations each agency head shall designate the Advocate for Competition and designees at a comparable level in major component organizations to regularly review set-aside decisions to assure compliance with these regulations within the component organization and the agency.

OMB Responsibility and Contact Point. Address questions or inquiries regarding this Bulletin to ____________________, the Office of Management and Budget, Office of Federal Procurement Policy, 725 Jackson Place, N.W., Room 9001, Washington, D.C. 20503. Telephone number (202) 395-5802.

William Mathis
Administrator (Acting)

QUESTIONS AND ANSWERS REGARDING SMALL BUSINESS SET-ASIDES

Q.1. What is the intended effect of the instruction to agencies to publish a proposed small business set-aside regulation, as issued by OFPP on February 21, 1986.

A.1. The notice is intended to initiate action to replace the current procurement regulation governing small business set-asides with one that is in concert with the Competition in Contracting Act of 1984 (CICA). The current regulation requires that contracting officers set-aside a procurement for exclusive small business participation where "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns, and (b) awards will be made at reasonable prices."

The proposed rule, based upon wording in the statute, requires that -- in order to set-aside a procurement -- contracting officers determine that the agency will receive a sufficient number of sealed bids or competitive proposals from responsible small business sources to fulfill the Government's requirements at the lowest reasonable cost. The three procurement regulatory agencies (DOD, GSA, and NASA) have been instructed to initiate the regulatory change by publishing the proposed regulation by March 23, 1986, for a 30-day period for public comment.

Q.2. Will elimination of the "rule of two" end small business set-asides?

A.2. No. Contracting officials will evaluate planned procurements in the same manner under the proposed regulations as they do under the current system. They will evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will review the purchase history of the item or service to determine if it has been previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business.

Q.3. What is the Administration's position on preferential procurement programs, generally, and on small business set-asides, in particular?

A.3. The Administration has consistently expressed support for programs which promote the development and growth of small businesses. To illustrate: small business set-asides were supported as part of the Administration's Proposal for a Uniform Federal Procurement System submitted to the Congress in February 1982. The legislative proposal which was submitted to implement the proposal served as a basis for the competition provisions of the Competition in Contracting Act of 1984 (P.L. 98-369), which recognizes small business set-asides as instances of "full and open competition" limited to small business contractors. Moreover, the President signed a proclamation last month declaring a National Small Business Week.

Q.4. If the "sufficient number/lowest reasonable cost" formula is implemented, what will be the effect upon the number of small business set-asides? (Some commenters have stated they will be reduced by 50%.) Shouldn't that be determined before such a regulation is adopted?

A.4. The legal effect of Section 2732 of the Competition in Contracting Act of 1984 imposes the "sufficient number/lowest reasonable cost" formula as a matter of law. The effect on the number of set-asides by adoption of this formula is not a matter which can alter adoption of the formula. Although the precise effect is impossible to calculate, as a practical matter, it does not appear that adoption of the formula will reduce the number of small business set-asides. There may be a temporary reduction until agency contracting personnel become familiar with the revised regulations. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Small Business Act. The regulations require that contracting officers review acquisitions to determine if they can be set-aside and provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Q.5. Will adoption of the "lowest reasonable cost" standard give any big business the opportunity to veto or set-aside merely by saying it is interested in submitting an offer?

A.5. No. Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond, from a cost standpoint, than is large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (P.L. 98-369, the Competition in Contracting Act of 1984, and P.L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business is substantially lower than that proposed by small business would a set-aside be cancelled. The GAO has previously upheld cancellation of a set-aside procurement when information bids from large businesses indicated that the small business' price is unreasonable.

Q.6. How could any contracting officer be assured of having the "lowest reasonable cost" if he does not let large businesses bid?

A.6. The answer must be stated and understood in terms of the law that established the requirement. The CICA requires "full and open competition," which means all firms, large and small, must be allowed to compete. It also requires "a sufficient number" of competitors to fulfill requirements at the "lowest reasonable cost." Both provisions would appear to negate small business set-asides. However, CICA very clearly exempted small busines set-asides from any encumberance by the provisions of the Act. Full and open competition was stated in the Act to exist when the competition is conducted solely among small businesses. Likewise, lowest reasonable cost must be read to mean the lowest reasonable cost among small businesses. Otherwise the expressed intent of Congress to retain the small business set-aside program would be violated.

Q.7. Under the proposed rule, if a large business comes forward and shows the contracting officer, through catalogue prices or otherwise, that its price is substantially lower than the prices paid to small business, will the contracting officer not set-aside the procurement?

A.7. The procurement would probably not be set-aside. However, it is important to know the reason. It is not because a large business expressed interest in the procurement. It is because the contracting officer must make awards at "reasonable" prices. If the information supplied by the large business merely showed that it would be competitive with a sufficient number of small businesses that, in themselves, assure competition, the procurement would be set-aside. This response would also hold true if asked with respect to the "rule of two." This regulation also does not allow a bad business decision by the contracting officer. In addition to having "at least two" small businesses, the contracting officer must determine that the competition will result in reasonable prices. If confronted with the same information from the same large business (substantially lower price), the procurement would not be set-aside even under the "rule of two."

Q.8. What will OFPP do if the three regulatory agencies fail to issue the regulation for comment by March 23, 1986? Will it issue a draft policy letter for comment?

A.8. If the regulatory agencies fail to issue proposed regulations by March 23, 1986, OFPP will attempt to discuss why such proposed regulations have not been issued. If it appears that proposed regulations are imminent (2-or-3 days), no action will be taken. If proposed regulations are not imminent, OFPP will utilize its regulatory authority under the OFPP Act (41 USC 405) and, as outlined in OFPP Policy Letter 85-1, issue proposed regulations to be implemented in the Federal Acquisition Regulation for 30 days' public comment. We fully expect, however, that such action will not be necessary.

Q.9. Was this proposed regulation discussed, at least informally, with representatives of the small business community (i.e., SBA, SADBUs, appropriate Congressional staff) prior to issuance? If not, why not?

A.9. There was no discussion with the small business community prior to issuance. It was not discussed because the proposed regulation results from a legal interpretation of the provisions of Section 2732 of the Competition in Contracting Act of 1984. The proposed regulation is, therefore, not considered a matter of policy wherein OFPP would discuss its proposal with interested parties. In this case, interested parties may express their views during the public comment period.

Q.10 If the CICA is what caused OFPP to issue the proposed instruction, why did OFPP wait over 18 months to do so? Specifically, what triggered this action?

A.10. After its initial review of the provisions of CICA, OFPP did not conclude that a revision of the regulations addressing small business set-asides was required by the statute. In December 1984, Congressmen Jack Brooks and Frank Horton and Senators William Cohen and Carl Levin wrote to the regulatory agencies concerning the proposed FAR implementation of CICA. Among the matters which they pointed out was the fact that "rule of two," contained in FAR Part 19, was not appropriate in view of the language in Section 2732 of CICA regarding "sufficient number" and "lowest reasonable cost." They, further, stated it was their intent, as co-sponsors of the legislation, to eliminate the "rule of two." The regulatory agencies disagreed, in a response to the members in August 1985. The matter was raised again in December 1985, by a letter from Congressmen Jack Brooks and Frank Horton to Joseph Wright, Deputy Director of OMB, asserting their view that the "rule of two" was contrary to the CICA. After a coordinated review by the OPPP and the General Counsel of OMB, it was concluded that the provisions of the CICA require that the regulations be revised to substitute the "sufficient number/lowest reasonable cost" formula for the "at least two/reasonable price" formula.

Q.11. Does the proposed approach apply to 8(a) firms — and the process by which they are awarded contracts? If not, why not?

A.11. The proposed approach will not apply to firms which are awarded subcontracts under Section 8(a) of the Small Business Act. It should be noted that Section 8(a) of the Small Business Act authorizes the Small Business Administration to enter into direct contracts with Federal agencies to provide goods and services by subcontracting the actual performance to small business firms which have been accepted into the business development program established by the Act. The regulations and procedures for 8(a) contracts and subcontracts are separate and apart from those governing small business set-asides and are unaffected by the OFPP notice.

In the event that a firm which is included in the 8(a) program chooses to seek direct procurements independent of the program, it would be subject to the standard FAR provisions, including the set-aside regulations.

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PRESIDENTIAL
ADVISORY COMMITTEE ON
SMALL & MINORITY
BUSINESS OWNERSHIP

1441 L Street, N.W.
Room 602
Washington, D.C. 20416
(202) 653-6851

February 24, 1986

President Ronald Reagan
The White House
Washington, D. C.

Dear Mr. President:

As members of your Advisory Committee on Small and Minority Business Ownership, we can personally attest to your keen interest in fostering opportunities for the U.S. small business sector of our economy. It is in this context that we feel a responsibility to alert you to a matter which will seriously impair opportunities for small companies to continue to do business with the federal government.

Over the years, small businesses have never participated in federal procurements in proportion to their contribution to the economy. For example, though small businesses account for approximately 38% of the GNP, they receive less than 17% of federal procurements.

To compensate for the inherent inequality of federal marketing opportunities between large and small companies, the Small Business Act of 1953 authorized the use of "set asides" for contracts deemed to be "...in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns..."(Sec. 15(a).

In 1962, dissatisfied with the procurements being set aside for small businesses, the Navy Department instituted a requirement that a procurement must be set aside if offers were obtained from at least two responsible small business sources at a reasonable price. This requirement proved effective and was subsequently adopted by the entire Defense Department and a number of civilian agencies.

With the recent consolidation of procurement regulations into the Federal Acquisition Regulations, the so called "Rule of Two" became a federal-wide regulation (Subsection 19.502-2).

It is natural that large business interests would wish to increase their share (now 83%) of federal procurements. They erroneously believe that zero based budgeting of the Small Business Administration signals a diminution of your interest in promoting the expansion of opportunities for small businesses. In consequence they have stepped up a campaign to repeal the "Rule of Two", and have also prevailed upon the Office of Federal Procurement Policy to instigate such action. We believe that this is most unwise, a step backward, and should be discouraged.

Mr. President, we respectfully bring this matter to your attention in the hope that you will ascertain the facts and determine the merit of our concern.

Respectfully yours,

c13

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

FEB 21 1986

MEMORANDUM TO: SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses "...if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices."

However, in July 1984, Section 2733 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. Therefore, further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter 85-1 that within 30 days of the date of this letter the following proposed regulations must be published for a 30 day comment period. This notice has been concurred in by the Director, OMB.

PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 — SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 — Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 — SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM January 29, 1986

TO: Jack Carley

FROM: Diane Weinstein

SUBJECT: Rule of Two -- Follow up on Yesterday's Memo

Bill Coleman says OFPP is willing to forego publication of the notice to the three agencies, but insists that they should be given 60 days to decide whether to publish the proposed rule (for 30 days' comment).

My fear, confirmed by Coleman's off-the-cuff comments, is that the three agencies will come back in 60 days with a substantially different proposed rule (as Coleman says, they can't be expected to just publish it in the form we asked). Then we will be at square one again (only with 60 days passed and still no proposed rule), effectively negotiating with the three agencies, e.g., about whether their proposal is "substantially" like ours and, even more fundamentally, when (or even whether) to actually propose rescinding the rule of two.

Coleman says they're not trying to stall: (1) the agencies simply need the time to "develop" a proposed rule, and (2) for diplomatic and precedential reasons (we have to keep up good relations with these agencies), we don't want to "jam this down their throats."

My responses are: (1) why do they need all this time if they're just making an up or down decision on whether to publish the proposed rule substantially as we've drafted it (remember too, that this is not exactly a novel issue and that the agencies have long been on notice (albeit informally) that something is afoot re changing the rule of two) and (2) giving them 30 days puts the burden on them to ask for, and, most importantly, explain why they need, more time. If the reason is that they're substantially redoing (i.e., gutting) the proposal, we can then negotiate, or go ahead and publish the rule ourselves, having lost only 30 days in carrying out Joe's promise to Brooks.

However, all this discussion may be mooted if Joe decides to go out directly with the proposed rule -- which he may just do out of frustration at the kind of continual bureaucratic bickering reflected by these tedious memos.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM

January 28, 1986

TO: Jack Carley

FROM: Diane Weinstein

SUBJECT: Rule of Two

I spoke with Bill Coleman of OFPP, who says you undertook to urge Joe to accept the "notice option."

Under this option OFPP would (1) notify the three procurement agencies (DoD, NASA and GSA), following the OFPP Policy Letter 85-1 procedures, (2) publish the notice in the Federal Register, and (3) give the three agencies 90 (or, if Joe objects, 60) days to publish the proposed rule for 30 (to 60) days' comment. Even without any additional delay by the three agencies, a final rule under these time frames could not be published for 90 (or up to 150) days.

I suggest we give the three agencies 30 days by which to publish the proposed rule for 30 days' comment (all that is required by the CICA amendment to the OFPP Act).

I also suggest that the notice to the three agencies not be published. Neither CICA nor OFPP Policy Letter 85-1 requires publication of a "notice" to the three agencies. Further, publishing the notice will serve only to build up preliminary agency and public pressure to "blow" any rule of two amendment "out of the water," before it is ever published as a proposed rule for comment.

Bill says OFPP "likes to" publish everything they do in the Federal Register; but this is clearly unnecessary and, from Joe's and Brooks' points of view, may be counterproductive.

What has happened here. Are we going to get what is agreed to or not? If not, let's just go ahead w/o this.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D.C. 20503

MEMORANDUM

January 16, 1986

TO: Joe Wright

FROM: Diane Weinstein DW

SUBJECT: Rule of Two

I met with David Baker ~~and Bud~~ Maraist yesterday. They discussed two alternatives to my "proposed rule" for resolving the "rule of two" problem. They were unsure whether you were familiar with these proposals.

First, they proposed the "Policy Letter" solution alluded to in Owen Birnbaum's proposed response to the Brooks-Horton letter. This is circulating for internal clearance now. This draft "Policy Letter 86-1" (attached) merely sets out the "policy" that contracting officers shall be "made aware" (1) of the terms of the CICA standard and (2) that "there may be instances where the receipt and consideration of an absolute minimum of two offers may not be adequate, especially where one of the sources is marginally responsible." They say you told Birnbaum/Mathis you were willing to consider a solution along these lines. However, ~~as Baker and Maraist admitted,~~ this is very unlikely to be satisfactory to Brooks et al.

?? I DON'T REMEMBER THIS AT ALL.

Their "fall-back" solution is a "Notice" (attached) to DoD, GSA and NASA, much like the "OFPP Bulletin" I suggested this fall. The Notice would give the three agencies a deadline (unspecified) to amend the FAR to implement CICA (using the language identical to that in the proposed rule I sent you last week).

You may recall that when we had first proposed the OFPP Bulletin as a means of giving the three procurement agencies an opportunity to change the FAR themselves, Mathis and Birnbaum argued that, because the three agencies were so firmly opposed to changing the rule, this would be futile and a waste of time. I am now informed that this was merely a "straw" argument and that the Notice will clearly inform ~~the three agencies that OMB~~/OFPP is serious and is likely to provoke appropriate action. Also, the ~~Notice~~ follows OFPP's new (but in my mind, unnecessarily restrictive) procedures for determining when the agencies have failed to "timely" issue regs (the statutory predicate to OFPP's exercising its prescriptive regulatory authority) in OFPP's August Policy Letter 85-1.

You should decide -- (perhaps after Gordon checks with Brooks' staff) but before the letter to Brooks/Horton goes out -- which course you want to pursue:

1. Birnbaum Policy Letter 86-1
2. Notice to DoD/NASA/GSA or
3. Proposed rule issued by OMB/OFPP

c: Jack Carley

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

January 14, 1986

TO: Joe Wright

FROM: Diane Weinstein DW

SUBJECT: Rule of Two (Response to Brooks, Horton Letter)

The Birnbaum draft response is not only unclear, as Gordon says, but inaccurate. I have redrafted it to reflect our understanding that OFPP will publish for comment a proposed rule revoking (not an "OFPP Policy Letter" revising) the "rule of two."

c: Jack Carley

Diane – OK – as revised -- but what are next steps?

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

DATE: 1/14/86

TO: Deanne Weinstein

FROM: GENERAL COUNSEL

Please note & let me know where we are when necessary.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

January 10, 1986

MEMORANDUM FOR JACK CARLEY

FROM: JOE WRIGHT

SUBJECT: "Rule of Two"

We should be going through final OFPP review prior to the comment period on this rule change. I told Will Taft/DOD that we were planning to come out with this proposal -- and naturally DOD wants to keep the Rule of Two. Would you please make sure that I get a copy of what we plan to send over to the Commerce Business Daily before it is sent so I can give Will a courtesy copy. Thanks.

cc Dave Wendler

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

January 7, 1986

MEMORANDUM

TO: Joe Wright

FROM: Diane Weinstein

SUBJECT: Rule of Two/SCAT

I enclose a draft "Proposed Rule" revoking the "rule of two." for Federal Register publication. Should someone at OFPP (Baker? Coleman?) review this before I put it in final? If so, should this be at your direction?

Also, is the possiblity of doing "SCAT" administratively still a live issue?

Cole Baker if so [illegible]

cc: Jack Carley

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15 DEC24
[illegible] UNIT

December 20, 1985

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

As you know, we strongly believe that the Federal procurement process should be made more competitive, so that agencies will receive the best appropriate goods and services at the lowest possible overall cost. The Competition in Contracting Act, enacted last year on our recommendation in Public Law 98-369, makes full and open competition the standard for Federal procurements.

A number of statutes and regulations, however, still interfere with appropriate implementation of this Act, and consequently deprive our citizens of the opportunity to get the best buys for their tax dollars. Prominent among these regulations is the "rule of two," which permits agency officials to set a contract aside for award only to a small business whenever the officials think that two or more small firms might want to perform the work. Once a contract is set aside, any efficient company which is larger than the size established under Small Business Administration regulations may not be awarded that contract--even if it can do the work better, and at a lower price, than a small firm can.

This "rule of two" was inserted into the Federal Acquisition Regulation without public comment prior to enactment of the Competition Act. It is clearly inconsistent with the spirit of that law. Furthermore, it has no basis in statute. In fact, in the same year that Congress approved the Act, the House of Representatives, at the urging of numerous committee chairmen and ranking minority members, chose not to consider a bill whose principal provision would have given statutory authority to the rule.

When the Competition Act became effective last April, the FAR should have been amended to bring the "rule of two" into conformity with the Act. Despite the inconsistency between the Act and the rule, and despite the numerous public comments which the Office of Federal Procurement Policy received in opposition to the rule at the end of 1984, the FAR still has not been amended.

We urge you and the OFPP to replace the rule with regulations which comply with the Competition Act and therefore further an objective which you and we share: achieving better buys through increased competition in Federal procurement.

Sincerely,

Jack Brooks
JACK BROOKS
Chairman

Frank
FRANK HORTON
Ranking Minority Member

22058

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

December 7, 1985

MEMORANDUM FOR GORDON WHEELER

FROM: JOE WRIGHT

SUBJECT: Rule of Two

Gordon -- as you know we have been going over this "Rule of Two" regulation for the last year and a half. Jack Brooks told me (and Frank Horton concurred) that it was their intent to get rid of the Rule of Two in CICA. OFPP feels very strongly that this would be the wrong move but their arguments simply don't have much credibility.

What I need is a quick note from Jack Brooks basically telling us to implement the provisions of CICA and get rid of the Rule of Two -- it is simply too controversial to proceed without those instructions. Would you talk to Bill Jones about this? Thanks.

cc: Diane Weinstein

MEMORANDUM December 4, 1985

TO: Jack Carley

FROM: Diane Weinstein

SUBJECT: Rule of Two

Joe Wright would like us to meet this week with him and Bill Mathis of OFPP on an issue that has been kicking about for some time now -- revision of the "rule of two," which is applied in making small business set-aside decisions under the Federal Acquisition Regulation (FAR) system.

Jack Brooks; his ranking minority member, Frank Horton; and their counterparts on the Senate Governmental Affairs Committee (Senators Cohen and Levin) have long (since the Competition in Contracting Act was enacted in July 1984) contended that the rule of two was made unlawful by CICA's amendment to the OFPP Act. See Attachment "A", letter from Brooks and Attachment "B", a joint letter to Mary Ann Gilleece from Brooks, Horton, Cohen and Levin, at p. 4.

We have agreed with Brooks et al. See January 15, 1985 Horowitz memo to Joe Wright (Attachment "C") and letter to Senator Heinz (Attachment "D").

The three principal procurement agencies (DoD, NASA, GSA) responded to the joint letter indicating no plan to take action to eliminate the rule of two in the final rules to implement CICA in the FAR, which are scheduled to be issued in February. Therefore, Joe requested options by which OMB or OFPP could require such implementation. These are set out in my memo of Oct. 1 (Attachment "E".) I have drafted an OFPP Bulletin to implement option III.3. in that memo. (Attachment "F").

The attached material should acquaint you with the principal legal issues. I assume Joe wants to discuss both legal and policy issues at our meeting.

Attachments

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D.C. 20503

OFFICE OF
THE DIRECTOR

October 19, 1985

NOTE FOR: MIKE HOROWITZ

FROM: JOE WRIGHT

Mike -- what has happened to the "Rule of Two" effort -- I thought we were going to send out an OMB circular complying with the legislation. Please look into this for me. Thanks.

DIANE

YOURS

M

ike- I have
sent Joe 2
emos and left
message with Maryann
hat I am awaiting *his*
ecision on how to proceed to
et *OFPP* to issue a *bulletin* on this. D. (see Option I.3 of attached memo)

[redacted]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM October 1, 1985

TO: Joe Wright

FROM: Diane Weinstein DW

RE: Rule of Two

Here are some alternatives for requiring FAR implementation of the Rule of Two changes required by CICA.

I. Formal OMB Action -- Most of these actions would be undertaken pursuant to OMB's general management authority, not under the OFPP Act, which limits the Director's authority to rescinding or denying promulgation of regulations that the OFPP Administrator determines are inconsistent with the OFPP Act's policies. Rescission of the Rule of Two is not enough; it must be replaced.

1. OMB Circular. An OMB circular is generally defined as a directive communicating significant governmentwide policy of a continuing nature.

Since changing the Rule of Two as suggested in the proposed circular would be a one-shot deal, this seems inappropriate. Also, circulars generally do not deal with such narrow issues as the Rule of Two. Finally, although we are not legally obligated to do so -- either under the APA or the Federal Register Act -- since 1978, new OMB circulars have been published for notice and comment. Thus, two publications would be required, first of the circular and again (as required by new Section 18 of the OFPP Act) for 30 days' notice and comment at the point the procurement agencies propose the required FAR revisions implementing the circular. In short, this alternative seems clumsy and will needlessly attract attention twice. Further, it may resuscitate unwanted (remember A-122) questions regarding the legal status of OMB circulars.

2. OMB Bulletin. An OMB bulletin is more appropriate than a circular in that it is designed to communicate transitory guidance to the agencies, or guidance that requires only one-time action. It would not have to be published. However, like a circular, it also would not be

yes

Diane — lets go Circular and get [illegible] with Brooks agreement

DW

self-implementing. The procurement agencies would still have to publish the FAR changes for 30 day notice and comment as required for all procurement regulations by the OFPP Act.

II. Formal OFPP Action.

1. OFPP Regulations. The most "clean" and direct way to implement the FAR Rule of Two changes required by CICA would be for OFPP to directly exercise its own regulatory authority under the 1983 reauthorization. The Act authorizes the Administrator to prescribe FAR regulations when DoD, NASA and GSA disagree (as they now at least arguably do, since the military agencies are now required by Cognress to use a dollar threshhold for initiating set asides) or when they fail to issue regulations in a timely manner. The latter rationale seems most appropriate, given the inordinate delay in implementing Brooks' desired CICA changes. (The long-awaited GSA/DoD/NASA response to the Brooks/Cohen/-Levin/-Horton letter on CICA contained only the following statement on "Rule of Two": "We do not interpret the "Rule of Two" to be in conflict with CICA. Use of the rule contemplates full and open competition after a set aside decision has been made.")

However, as everyone seems to agree, the Rule of Two is not the best vehicle for this maiden OFPP effort to exercise its regulatory authority.

2. OFPP Policy Letter. Like the OMB Circular, an OFPP policy letter is a directive of continuing nature, which is generally published and is not self-implementing (new FAR regulations would still be required to be published for comment, etc.).

3. OFPP Bulletin. Although there is currently no such creature, one could theoretically be created, by analogy to the OMB Bulletin, to deal with one-time action such as this. This would not have to be published.

III. Informal OMB/OFPP Action.

The best solution, although by no means guaranteed of success, may be for OFPP and OMB to make a concerted effort (carrying but not wielding the big stick of OFPP's prescriptive regulatory authority) to convince the procurement agencies of the need to revise the FAR regulations on their own. This will require the devotion (not the mere "assignment") of OFPP staff to this cause and may have to await appointment of a new Administrator for maximum effectiveness.

Recommendation:

I recommend option III -- that we lean on OFPP to, in turn, lean hard (in writing, if necessary) on the procurement agencies to do this without forcing us to initiate formal OFPP/OMB action. This can be an opportunity for them to show (as they may soon very much want to -- once a new authoritative regime is in place at OFPP) that the process can work to accommodate OFPP "policy direction" without formal OFPP regulatory action or public confrontation.

Alternatively, and if the foregoing approach doesn't work soon, (or appear likely to work at all) an "OFPP Bulletin," as in option II.3., may serve to let the FAR agencies know exactly what is wanted and may be a neat -- and graphic -- first step putting them on notice that more formal unilateral OFPP prescriptive regulatory action is being considered.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM September 19, 1985

TO: Joe Wright

FROM: Diane Weinstein DW

SUBJECT: Rule of Two

As you requested, I met with Bob Thompson yesterday on the Rule of Two Circular idea.

He and I basically agree on content -- what DoD, NASA and GSA should be instructed to put in revised uniform FAR regulations in order to fully implement the CICA competition requirements for small business set asides. To his latest suggestions, I added the idea of using the newly created "advocates for competition" to monitor proper application of the new competition standard (in short, to pit the competition advocates against the small business reps). OK

However, I have serious reservations about the form of Bob's proposal -- to use an OMB Circular as the implementing vehicle. (Actually, the Circular would not be self-implementing; the three procurement agencies would still have to take steps -- including following the new OFPP Act 30 day notice and comment procedures -- to implement the Circular in the FAR.)

The OFPP Act gives the Administrator (not the Director of OMB, as Thompson's Counsel, Karen Hastie Williams, the former OFPP Administrator, maintains) the authority to prescribe FAR regulations when -- as here -- DoD, NASA and GSA disagree or, more to the point, fail to issue regulations in a timely manner. However, OFPP's prescriptive regulatory authority has not to date been exercised and I question the advisability of making this critical maiden effort over the Rule of Two issue. Agree

The Director's regulatory power is currently limited to rescinding or denying promulgation of regulations which the OFPP Administrator determines are inconsistent with the Act's policies. This authority, although it could theoretically be used to repeal the current Rule of Two, would not get us a new set-aside rule.

Therefore, we should consider other alternatives to the Circular (or to OFPP's use of its new regulatory authority) for implementing the CICA set-aside requirements. OFPP could be helpful on this -- e.g., by proposing other alternatives or, even better, by pressuring GSA/NASA/DoD to do the right thing, without waiting for formal OMB/OFPP direction. However, the prospects of OFPP succeeding with the latter approach appear bleak?

I will shortly prepare for you a comprehensive list of implementing options.

OK

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D C 20301-8000

ACQUISITION AND
LOGISTICS

DASD(P)/DARS

AUG 15 1985

Mr. William E. Mathis
Acting Administrator
Office of Procurement Policy
726 Jackson Place, N.W.
Washington, D.C. 20503

Dear Mr. Mathis:

Subject: Response to Members of Congress Concerning FAR Implementation of the Competition in Contracting Act

In response to your memorandum of July 31, 1985, attached is a copy of our reply to the July 19, 1985, letter from Congressmen Brooks and Horton. A similar letter will also be sent to Senators Cohen and Levin as a further response to the letter of December 12, 1984, signed by each of the four members.

Our proposed reply addresses each of the concerns addressed in your memorandum, including our progress and future schedule in completing FAR revisions to conform with CICA.

Be assured that we will personally monitor this effort to ensure that any issues are promptly resolved and that the final rule implementation of CICA is timely promulgated.

We plan to release our reply to Congress on 16 August 1985.

Sincerely,

Eleanor Spector
DEPARTMENT OF DEFENSE
ELEANOR R. SPECTOR
Deputy Assistant Secretary
of Defense for Procurement

GENERAL SERVICES
ADMINISTRATION
ALLAN W. BERES
Assistant Administrator
for Acquisition Policy

NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION
S. J. EVANS
Assistant Administrator
for Procurement

Attachment
Copy/Ltr to Congressmen
Brooks & Horton

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JUL 10 1985

Horowitz —
Comments
ASAP please.
Joe

MEMORANDUM FOR JOE WRIGHT

FROM: Bill Mathis Bill

SUBJECT: Small Business Size Standards

You asked about the effect of a possible reduction from $7.5 to $1.5 million in the size standard for construction-related A/E services and its relationship to the Rule of At Least Two.

Since Bill Birkhofer (ACEC) earlier indicated to us that his real problem was the size standard not the "rule", the change should be very helpful in reducing his (and Congressman Brooks') opposition to the rule. SBA has been cooperative in action to lower the standard. However, we still have not reached an agreement with Birkhofer (and Chairman Brooks) on language to be added to the FAR regarding application of the rule to A/E procurement.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JUN 19 1985

MEMORANDUM TO JOE WRIGHT

FROM: BILL MATHIS Bill

SUBJECT: Rule of At Least Two (RLT/TSAP)

Here is the information you requested on Mike's behalf in your May 30 memorandum to me.

In your memo you refer to my estimate of average numbers of bids on DOD, GSA, and NASA small business set-asides (10; 10; and 12, respectively). The basis for my estimate is the SBA Administrator's January 11, 1985 letter to me on the RLT/TSAP, which states in pertinent part:

> "It is an established fact that once a procurement is set aside, competition is increased. The Department of Defense averages 10 small businesses bidding on set-asides, the National Aeronautics and Space Administration 12, and the General Services Administration more than 10. Unrestricted procurements do not bring this number of bids in most instances."

This data was orally confirmed to me several months ago by representatives of the three agencies. Information of this sort is not routinely collected in an automated system. The only indicator involving competition in the automated system is competition vis-à-vis single source. We have not perceived a need to capture data on the number of bids (proposals) received for each procurement. We also note the April 18, 1984, letter to Mr. Stockman of the Deputy Under Secretary of Defense, (Acquisition Management) which states:

> "We would like to note that small business set-asides generally result in more, not less, competition. This increase in competition results because of two factors: There are a much greater number of small business firms than big business firms; secondly, the small business community perceives that when a procurement is set-aside, it, by definition, cannot be a sole source award and that they will be competing against their peers and, therefore, stand a realistic chance of winning the contract."

The general belief that small business set-asides are more competitive than "unrestricted" competition is more than anecdotal. It represents common knowledge and observation of experienced contracting officers, PCR's (procurement center representatives) and knowledgeable procurement officials.

We submit that the precise number of bids received on a small business set-aside (8, 10, or 12, etc.) is relatively unimportant. The important fact is that set-asides are highly competitive and completely consistent with both the letter and spirit of CICA and the Small Business and Federal Procurement Competition Enhancement Act of 1984.

The information requested in the fourth paragraph of your memorandum, for FY 1984, is as follows:

1. Number of acquisitions set aside under FAR 19.502: 8,178,944.*
2. Dollar volume of acquisitions set aside under FAR 19.502: $14.477B.
3. There is no information presently available as to the "average number of bids received once an acquisition is set under section 19.502." OSD advises that it would take a minimum of six months to develop this information, if it can be developed at all. A manual review of the approximately 8.18 million contract actions would involve numerous locations and substantial manpower. OSD has indicated it would be reluctant to expend millions of man-hours on such an effort.
4. This data is not available and would have to be collected during the manual review.
5. The precise number of set-aside determinations withdrawn under FAR 19.506 is not available. It is believed, however, that very few set-asides are withdrawn.

As you know, at our last meeting Mike agreed to contact Stu Evans, Mary Ann Gilleece and Allan Beres to obtain this data. We would be interested to know how our information compares to the data he obtained.

Finally, I am attaching some correspondence that OSD thought might be of interest to OMB/OFPP.

Attachments

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* Of the 8,178,944 set-asides, approximately 5,600,000 were exclusive reservations, under section 221 of P.L. 95-507, of small purchases under $10,000. Such reservations, incidentally, were made under a legislatively mandated Rule of At Least Two.

cc: Arlene Triplett

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

May 30, 1985

MEMORANDUM FOR: BILL MATHIS
FROM: JOE WRIGHT
SUBJECT: Rule of Two

Bill -- thanks for your input on this issue - Mike now needs some information. I would like to get this resolved as soon as possible.

In our earlier discussions on the Rule of Two, you referred to certain estimates on the average number of offers received once a procurement was set aside under the FAR Total Set-Asides provision (TSAP). As I recall, the figures were 10 for GSA and DOD and 12 for NASA. You also stated that it was your impression that small business set-asides rarely resulted in less than five offers. Unfortunately, Mike Horowitz has been unable to obtain verification of these figures. His information is that such data is not routinely collected and, thus, exists only anecdotally. Is this true?

In order to properly evaluate alternatives for revising the FAR TSAP consistently with the requirements of the 1984 Competition in Contracting Act amendments to the OFPP Act, we need more precise historical data on the number of offers received in TSAP set asides.

Therefore, would you please find out the source of the estimates you mentioned. Also, to the extent it is available, provide me with the following additional data (and its source), by agency if possible, for FY 1984, or the next most recent year, by C.O.B. June 14:

1. Number of acquisitions set aside under FAR Section 19.502.
2. Dollar volume of acquisitions set aside under Section 19.502.
3. Average number of bids received once an acquisition is set aside under Section 19.502.

4. Number of percentage of acquisitions, including repetitive set-asides, awarded under Section 19.502 on the basis of: (1) less than 3 bids; (2) less than 5 bids; (3) less than 10 bids.

5. Number or percentage of set-aside determinations withdrawn under FAR Section 19.506.

Thanks -- I'll set up another meeting in the next several weeks.

cc: Arlene Triplett
Mike Horowitz

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM

MAY 6 1985

AT — Can you make any sense out of this? Joe

TO: Arlene Triplett

FROM: Mike Horowitz MH

SUBJECT: Letter to Heinz re Rule of Two

Diane Weinstein and Owen Birnbaum have largely agreed on the revised draft of the Heinz response. However, I think both of the insertions newly added by Owen should be dropped.

1. The first sentence of the first insertion purports to rectify a misconception that Owen claims is common (shared, for example, by Don Sowle), that only two solicitations are required by the Rule. However, the rule does not mention solicitation at all. Further, once the set aside is made, an award can be made even if there is only one "solicitation." The second sentence of this insertion merely restates the rule of two. Thus, the insertion is at once misleading and redundant -- and should be deleted.

I don't have a problem with insert

2. The second insertion establishes a false dichotomy between "the necessity of receiving a sufficient number of proposals to insure the lowest reasonable cost" under CICA and the "criteria upon which a contracting officer institutes a set-aside" under the FAR set-aside provision. First, the CICA provision at issue here does not mandate an agency's actually "receiving a sufficient number, etc.," but rather its establishing procedures that will assure "receiving a sufficient number, etc." The criteria for the set aside are applied in an equally prospective manner -- a contracting officer must (determine) that under the set aside he will be "receiving a sufficient number etc." Thus, the CICA test is for all practical purposes identical to (and, in fact, uses parallel language to) the set aside test. In short, the second insert is both confusing and inaccurate and should also be deleted.

cc: Owen Birnbaum
✓Joe Wright

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAY 3 1985

AT —
What do you think?
Jim

MEMORANDUM FOR JOE WRIGHT

FROM: BILL MATHIS Bill

SUBJECT: Rule of At Least Two

At the conclusion of our final meeting on Thursday, April 25, you asked that I prepare a memorandum of the differences between the Rule of At Least Two (Total Set-Aside Procedures or TSAP) and Mike Horowitz's proposal to select a number higher than two. As I understand Mike's proposal of a "greater number than two" it envisions, also, a mechanism for reducing or increasing the fixed number.

First, the Rule of At Least Two: DOD adopted the Rule in 1979 after reviewing the Navy's extensive experience with it. It did so precisely because it embodied a fixed, minimum number (two). As explained in my earlier memorandum, DOD's pre-1979 experience was: (1) contracting officers somehow never found a "sufficient number" of small firms necessary to institute a set-aside; (2) "two" was, obviously, a quantifiable number which historically had been (and still is) the minimum number constituting competition.*

As Owen Birnbaum and I explained last Thursday, it would seem difficult (if not impossible) to explain how "more than one" is sufficient competition for an expenditure of $26 million dollars with a large firm, but not sufficient for a contract with a small firm for $26,000. As you know, the CICA defines competition as "receiving more than one sealed bid". However, during FY 1984, approximately $110 billion out of a total of $182.8 billion was expended on contracts where only one proposal was received.

Mike Horowitz's latest proposal for a higher fixed number (say, five) would establish a different, more stringent standard for procurement from small business than from large business. In addition to being arbitrarily discriminatory against small businesses it might well diminish competition from small businesses in the highly publicized area of procurement of spare and replacement parts. Mike's system could work well only where five or more small firms were clearly available. Whenever fewer firms were available it would present problems of administration as well as contract award. In short, the concept proposed creates a wholly new world of what constitutes competition and applies it only to small business - an impolitic and probably indefensible result.

WHY?

WHY?

~~[illegible]~~
But this!
For
purposes of
set-asides
not
[illegible]

---

* Section 2711(a)(1) of the 1984 CICA amends the law to state that "In determining the competitive procedures appropriate under the circumstance, an executive agency shall solicit sealed bids if . . . there is a reasonable expectation of receiving more than one sealed bid." (Emphasis added.)

Mike Horowitz's argument seems not to recognize the difference between the contracting officer's decision to initiate a set-aside and the CICA requirement that agency heads increase the use of free and open competition to insure receipt of a "sufficient number" of proposals from responsible sources at the lowest reasonable cost. The former decision is simply a device to institute a small business set-aside (authorized by the Small Business Act and, again, specifically as a competitive procedure in both CICA and the subsequent P.L. 98-577) based on the expected availability of at least two small firms. The latter criterion is merely a restatement - albeit a firm one - of the long-standing requirement that agencies and contracting officers receive a sufficient number of proposals to ensure that award will be made at the lowest reasonable cost. Indeed, it has always been required that a contracting officer may not make an award if the lowest price is not reasonable.

If any procedure such as Mike's is adopted (and I strongly counsel against it), I recommend that the contracting officer decide upon, announce, and record the quantified minimum number well in advance of proceeding with the procurement. I should note that such a procedure would greatly complicate the procurement process with the probable result of considerably few set-asides for small business, including those for spare parts. I fully expect DOD will oppose the idea but you can mention it to Secretary Taft when you discuss the TSAP with him.

While we do not recommend it, a "sufficient number" standard for initiating a set-aside would be preferable to setting a specific number greater than two because it does not have the "dual standard" problem. We would, however, under the "sufficient number" standard be again confronted with the problem DOD solved in 1979 when it adopted the "Rule of at Least Two".

Finally, I must add, in terms of the present deserved stress on obtaining competition, that small business set-asides are an exemplary form of procurement. As NASA, GSA, and DOD (Secretary Taft) will affirm, far more competition is obtained in this type of procurement than in any other.

cc: Arlene Triplett

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM April 23, 1985

TO: Joe Wright

FROM: Michael Horowitz MH

SUBJECT: Rule of Two

Pleased as I am that Bill Mathis and Bill Birkhofer have worked out congenial solutions (e.g., tiering, etc.) to the ACEC's special concerns, I must reiterate that merely adding some hortatory "cautionary" language -- effectively as an after-thought -- to the FAR rule of two provision does not, in my opinion, comply with the intent of the CICA requirement, articulated in the Brooks letter, that the Rule of Two be abolished in its entirety.

Furthermore, I have serious doubts that SBA approval to tiering small business set asides for selected "controversial areas" can be secured. Absent such approval, OFPP's authority unilaterally to institute such tiering through the FAR system is highly questionable.

The problem with the Rule of Two is not that it hurts A & E firms -- or any specific industry -- but that it is mechanically applied, without regard to whether a set aside will result in a sufficient number of bids to assure awards at the "lowest reasonable cost," as CICA requires. The problem of mechanical application of the rule of two is compounded by the FAR's requirement that only decisions not to set aside a procurement be documented.

Therefore, once again, it is my legal opinion that the Rule of Two must be replaced with the new CICA language. If an after-thought is necessary, I am willing to consider adding a statement acknowledging that "two" may in certain circumstances be a "sufficient number," but that any set aside based on such a small number must be specifically documented.

cc: Arlene Triplett

cc: Mrs. Tripl

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

APR 18 1985

MEMORANDUM THRU: ARLENE TRIPLETT

TO: JOSEPH WRIGHT

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR Bill

SUBJECT: Rule of At Least Two

After our meeting last Friday I moved to implement your suggestions on amending FAR 19.505-2, Total Set-Asides Provision (TSAP) re the "Rule of At Least Two."

First, Owen Birnbaum and I met with a staff member of the Senate Small Business Committee authorized to speak for Bob Dotchin, the Staff Director. The representative, Bill Montalto, was receptive to our suggestions that: (1) A&E procurements be tiered to "marry" the size of competing A&E firms with the size of the procurement (see our memo to you of April 3, 1985); (2) Prevent excessive subcontracting by small firms receiving awards under small business set-asides; (3) Carefully examine the anomaly of awards to a small or minority company in an amount greater than its size standard. He was also impressed with our plans to revise the FAR, discussed in detail below, to stress more selective set-aside procedures.

Second, we met with Bill Birkhofer, Associate Director, of the American Consulting Engineers Council (ACEC). He, also, was receptive to the proposals set forth in the preceding paragraph. We discussed with Birkhofer the TSAP ("Rule of at Least Two") in great detail. We agreed in principle, and even in some detail, on an amendment to the TSAP (FAR 19.502.2) to caution contracting officers that they: (1) should not apply the set-aside procedures mechanically or unthinkingly; (2) should consider the Government's need for high-quality items, particularly in high-tech areas; and (3) must follow the CICA requirement for receipt of a "sufficient number" of bids from responsible sources to fulfill the Government's requirements at the lowest reasonable cost.

Birkhofer admitted to us, quite candidly but not for general dissemination, that the "Rule of at Least Two" was not his problem but that he used it to "get the Government's attention." His problem, frankly stated, is SBA's unreasonably high size standard and his frustration since 1981 in getting the standard lowered. In my opinion, the standard of $7.5 million of sales averaged over a three year period is too high and should probably be set at $2,000,000. I will be pleased to demonstrate the basis for that judgment.

I am not happy at the slow pace at which SBA is moving on the matters we discussed with Frank Swain, Don Young, et.al. almost a month ago. I prefer to move in concert with them but am prepared to proceed without them, if necessary.

(Attachment U)

Time Line

1.	Aug. 30, 1974	OFPP established, given directive authority. P.L. 93-400.
2.	1979	OFPP Reauthorization; authority limited to policy guidance, focus on development of UFPS. P.L. 96-83.
3.	July 10, 1980	OFPP Policy Letter 80-5 formally establishes FAR system.
4.	March 17, 1982	E.O. 12352 directs DoD, NASA, GSA, to finish FAR by end of 1982.
5.	Sept. 19, 1983	FAR published.
6.	Dec. 1, 1983	OFPP Reauthorization; directive regulatory authority restored. P.L. 98-191.
7.	March 14, 1983	Brooks letter to DAS re "rule of two" in FAR 19.502-2.
8	Feb. 21, 1984 -	Memo of Understanding for FAR maintenance DoD / GSA / NASA 1st codified in CFR DAR / CAA Councils
9 ~~8~~.	April 1, 1984	FAR effective.
10 ~~9~~.	July 18, 1984	CICA, P.L. 98-369, amends OFPP Act (CICA is Title VII of DEFRA). Conference Report indicates that Rule of Two is no longer sufficient to ensure competition ~~even~~ in set aside programs.
11 ~~10~~.	Oct. 12, 1984	OFPP Notice of Comment on Rule of Two.
12 ~~11~~.	Dec. 12, 1984	GAO/Brooks letter re CICA implementation in FAR.
13.	Dec. 14, 1984	OMB Bulletin 85-7 Fed. Reg. Review E.O. 12291 §5 - Reg Agenda & §3+4 - exempt [illegible]
14 ~~12~~.	Jan. 11, 1985	FAC 84-5. Circular revising FAR, adding Part 6 Competition Requirements to FAR, implementation to begin immediately. ① CICA impl. ② program payments ③ source selection
15 ~~13~~.	~~Feb. 21,~~ April 1, 1985	CICA effective date.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM

April 16, 1985

To: Joe Wright

From: Mike Horowitz MH

Subject: Rule of Two

The Mathis "compromise" is in my view unacceptable -- both on policy grounds and because it still fails to comply with the Brooks DEFRA announcement. Moreover, it is my understanding that you promised Brooks that we sould institute an appropriate rule of two reform in the FAR.

I have withheld pushing for reform pending a decision and implementation of that decision or the OFPP Administrator.

Please advise.

THE DEPUTY SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

5 APR 1985

Mr. Donald W. Tidd
President
Association of Small Research, Engineering
  and Technical Services Companies
P. O. Box 6306
McLean, Virginia 22106

Dear Mr. Tidd:

Thank you for your letter requesting my office to support the "Rule of Two or More" because of the adverse effects a revision of this rule would have on the small business community.

The "Rule of Two or More" was adopted by the Navy in the early sixties and implemented throughout the Department of Defense in July, 1979. Since then, we have seen small business set-asides grow from 7.2% to 10.0% of our prime contract awards. This increase has occurred in spite of a changing procurement mix that resulted in larger expenditures for major weapons systems.

Our support of the "Rule of Two or More" is very clear, as evidenced by the enclosure. Additionally, I have personally expressed my concern to the Deputy Director of the Office of Management and Budget that this rule be retained unchanged.

We appreciate the support provided to the Department of Defense by your association and its members. You may be assured of our best efforts to retain the "Rule of Two or More."

Sincerely,

William H. Taft IV

William H. Taft, IV

Enclosure

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

APR 3 1985

MEMORANDUM THRU: ARLENE TRIPLETT AT see note

TO: JOSEPH WRIGHT
6/1

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two — A - Set up 1/2 hr mtg on Fri. AT. BM + MN.

By its Federal Register notice of October 12, 1984, OFPP solicited views on the "Rule of At Least Two" as set forth in Part 19 of the Federal Acquisition Regulation (FAR). The October 1984 publication resulted from criticism that this provision in the FAR had not been publicized and available for public comment in the FAR process.

OFPP has now completed its analysis of comments received in response to the Federal Register notice and needs your advice and guidance on developing OMB's position on this matter. In response to the notice we received 199 comments, of which seventy-two (72) supported the rule and 127 opposed it.*

a. 72 comments supporting the rule: Of the private sector comments almost all were from small and minority businesses. Generally, these comments noted that prior to the rule contracting officers could, and did, avoid making set-asides under the subjective "sufficient number" standard. Further, that the set-aside program was a critical element in the Government's small business program and that the survival of small and minority businesses was at stake.

b. 127 comments opposing the rule: Of the private sector comments almost all were from what appeared to be large companies or trade associations.

Many architect/engineer or construction companies commented in opposition to the rule. Many comments combined specific opposition to the rule with general criticism of the small business set-aside program itself.

Among the arguments contained in the "opposing" comments were that the rule is: Inconsistent with the new standard of "sufficient number" set forth in the 1984 Competition in Contracting Act (CICA); does not afford the contracting officer sufficient discretion in initiating a set-aside; has led, in certain industries, to disproportionate shares going to small business, etc. As noted, some of the comments were directed not against the rule but related to shortcomings in the actual operation of the set-aside program itself.

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*These figures are necessarily approximations. In some instances, numerous "offices" or "divisions" of a parent company sent in separate letters, largely identical. Some letters both "supported" and "criticized" the rule. Some criticized the set-aside program rather than the rule. All of this made precise "counting" very difficult. On balance, however, it is fair to say that 72 comments supported the rule and 127 opposed it.

Because several of these arguments appeared to have merit, we met with Frank Swain and other SBA officials. We advised SBA of our concern that a small company could apparently receive an award under a set-aside and then subcontract an inordinate percentage to a large business. Swain acknowledged SBA has no procedure in place to prevent this and promised prompt action. We also recommended that SBA investigate the possibility of "tiering" set-asides in A-E (construction) and other controversial areas. (For example, on a proposed procurement of, say, under $150,000 only firms with gross receipts of under $ x million could bid; on a procurement of $300,000 only firms with receipts of under $ y million could bid; and on procurements over a certain amount there would be no set-aside). Finally, we noted the anomaly of a small or a minority firm receiving a contract in a value greater than its size standard. SBA (Swain) will report back to us on these issues by the end of the month.

Secretary Taft, we understand, has a continuing and abiding interest in this matter. DOD (Taft) says it likes the rule and needs it.

The FAR staff has issued its interim implementation of CICA. The implementation does not address the issue of the rule.

The OFPP recommendation is to maintain the status quo and retain the rule. Our recommendation is based on the following: (1) The rule is a critical element in the small business set-aside program which, in turn, is a mainstay of the entire small business program. (2) The small business community, as well as the minority business community, is solidly behind the rule. (3) The FAR implementation is consistent with the CICA requirement for agency procedures to assure receipt of a "sufficient number of sealed bids or competitive proposals" with awards at the "lowest reasonable cost." (The set-aside program, incidentally, was firmly endorsed by Mr. Stockman in his recent testimony before the Senate Small Business Committee. Also, a vigorous small business community helps to keep large business more competitive.) (4) Almost all the agencies (not just DOD) support the rule. DOD formally instituted the rule in 1979 and Navy has used it for more than 20 years. (5) Deficiencies and shortcomings of the set-aside program, itself, can be remedied along the lines of our recent conversation with Swain, et. al. at SBA.

TO OFPP:

☒ See me

☐ Keep the FAR as is

☐ Use compromise language in my memo to Arlene Triplett of March 6, 1985

☐ Eliminate rule on the basis of Mike Howowitz's legal memorandum of Jan. 15, 1985

cc:
Mike Horowitz

MAR 6 1985

MEMORANDUM FOR ARLENE TRIPLETT

FROM: Bill Mathis WILLIAM T. [illegible]

SUBJECT: Rule of Two

Attached is some proposed language to effect the compromise you requested. I believe the language draws the necessary distinction between initiating a set-aside procurement action and the important Competition in Contracting Act language requiring receipt of a sufficient number of competitive bids or proposals and award at the lowest reasonable cost. I hope this compromise will be acceptable to the procuring agencies and satisfy Mike Horowitz's legal concerns.

19.502-2 Total set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as to partial set-asides). Notwithstanding the foregoing, contracting officers are cautioned that the Office of Federal Procurement Policy Act, as amended by the Competition in Contracting Act of 1984, requires that under set-asides there be received a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured.

Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM February 22, 1985

TO: Joe Wright

FROM: Michael Horowitz MH

SUBJECT: Rule of Two

You have asked for a status report on the "rule of two" issue.

In a word, OFPP has done nothing, notwithstanding the fact that Brooks/GAO are absolutely right about the mandate of DEFRA (which overrides the current FAR rule of two provision) and notwithstanding OFPP's clear authority under the OFPP Act to "prescribe regulations" when it "determines that [DoD, NASA and GSA] are unable to agree on or fail to issue Government-wide [FAR] regulations, procedures and forms in a timely manner." (Emphasis added.) 41 U.S.C. 405(b).

Nor do the FAR Councils or GSA/NASA/DoD plan to even consider revisions to the FAR further until well after CICA becomes effective in April, and probably not until summer at the earliest.

Not only is there no action on the rule of two, but neither has OFPP acted to address the other recomendations made in the Brooks/GAO letter. With minor exceptions, these recommendations are not incorporated in the current FAR, even as recently revised (by interim rule on January 11). They too appear well-warranted in light of the DEFRA changes.

I will shortly need to insist on compliance with DEFRA -- before the April 1 CICA date unless there are overriding reasons justifying a longer delay.

Because matters are now in flux as to OFPP, I have withheld action.

Please advise as to your thoughts/instructions.

Mike - Agree - Set up session w OFPP in [illegible] your people [illegible]

C

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM

January 15, 1985

TO: Joe Wright

FROM: Mike Horowitz MH

RE: Rule of Two

1. This opinion concerns the legality of the "rule of two" now applied in set-aside decisions under new FAR 19.502-2.

2. Following my examination of the statute and its legislative history, I fully concur in the Brooks-Horton-Cohen-Levin view of the law. It is, accordingly, my opinion that the rule of two is inconsistent with the new standard enacted by the Competition in Contracting Act of 1984 (CICA), Title VII of the Deficit Reduction Act of 1984, P.L. 98-369. Consequently, I propose revising the offending FAR, not only to incorporate the "sufficient number of bids" standard established by CICA, but also, equally importantly, to ensure that these bids will result in awards at the "lowest reasonable cost," the second prong of the new CICA standard.

3. The Small Business Act (15 USC 644) authorizes the use of set-aside procurement for small businesses when it is determined to be (1) in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) in the interest of war or national defense programs, (3) in the interest of assuring that "a fair proportion of total purchases and contracts for property and services for the Government are placed in small business concerns" or (4) in assuring that "a fair proportion of the total sales of Government property be made to small business concerns."

4. FAR 19.502-2 was included in the comprehensive revisions to the FARs published in September, 1983, effective on April 1, 1984. Another set of revisions, purportedly incorporating the changes required by CICA, was published for comment on October 1, 1984 and submitted to the printer on December 1, 1984.

5. FAR 19.502-2 (which is not modified by the latest revision) implements Section 15 of the Small Business Act by providing that an individual acquisition or class of acquisitions "shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be

made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists." (Emphasis added.) Partial set-asides are also made subject to this standard.

6. On March 14, 1984 Congressman Brooks wrote to the Director complaining that the "rule of two" set-aside provisions in the final FAR 19.502-2 rule (1) were not included in the version that went out for public comment and (2) violate the law.

7. Don Sowle's May 30, 1984 response to Brooks understandably focused almost exclusively on whether the FAR properly implements the Small Business Act, contending that the "issue is not the method of determining the existence of adequate competition among small businesses" but, rather, the propriety of set-asides, which he felt had been resolved by Congress in the Small Business Act in favor of "non-procurement related public policies (socio-economic goals)."

8. CICA, Title VII of the Deficit Reduction Act of 1984, contains several provisions relating to competition in procurement, amending both the Federal Property and Administrative Services Act of 1949 (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Property Procurement Act (OFPPA). The CICA amendment to Section 16 of the OFPPA was a conference committee substitute. It mandates that executive agencies increase the use of "full and open competition" in procurement by "establishing ... procedures ... that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.) The conference report explains that this language is applicable when agencies are "using competitive procedures" and that the requirement "applies to all agency procurements, including those made under set-aside programs." (Note that old FPR 1-1.706-5 permitted total set asides under a "sufficient number" standard.)

9. It is my opinion that the CICA amendment to Section 16 of the OFPPA requires that the "rule of two" in the FAR set-aside regulations be replaced by a "sufficient number of bids" standard and that the "at reasonable prices" standard be changed to CICA's "lowest reasonable cost" test. In some circumstances full and open competition (the lowest reasonable cost) may be assumed on the basis of only two bids. However, the crucial test is competitiveness, not, as is the case with a rule of two, the lowest possible number.

10. Both OMB and OFPP have authority to ensure that the CICA changes are implemented in the revised FARs. Section 6(a) of the OFPPA vests in the Administrator of OFPP the "overall direction of procurement policy and leadership in the development of procurement systems of executive agencies" and, as a result of

the 1983 amendments restoring OFPP's regulatory authority, is authorized to "prescribe Government-wide procurement policies which shall be implemented in the single system of Government-wide procurement regulations...." Section 405 of Title 41, U.S. Code, gives the Administrator the authority, and directs him, "to promulgate a single, simplified, uniform Federal procurement regulation and to establish procedures for insuring compliance with such provisions by all Federal agencies." In addition, Section 6(b) permits the Administrator to prescribe Government-wide regulations when DoD, NASA and GSA are "unable to agree on or fail to issue Government-wide regulations ... in a timely manner." Finally, and most importantly, in Section 6(f) of the OFPPA, the Director of OMB is given ultimate oversight authority over agency procurement regulations, being empowered to "deny the promulgation of or rescind any Government-wide regulation or final rule or regulation of any executive agency relating to procurement if the Administrator determines that such rule or regulation is inconsistent with the policies set forth in section 401 of [the Act] or any policies, regulations, or procedures issued pursuant to [Section 6(a) of the Act]." The section 401 policies include "promoting full and open competition" and "establishing ... procedures ... which will provide ... property and services ... at the lowest reasonable cost." Section 6(a) of the Act, described above, vests in the Administrator the overall direction of procurement policy. In short, OFPP has regulatory authority in the event, as with the rule of two, of agency disagreement, as well as when a regulation is inconsistent with OFPP's policies -- such as that of full and fair competition, cited both in Section 401 and in the CICA amendment to Section 16.

11. I am informed that many of the changes which the GAO/Brooks letter found to be required by CICA have not been made and will not appear in the FAR revision which is now at the printers - purportedly because the recommended changes were not received in time to permit the FAR regulations to be in place and ready for implementation on April 1, 1984, the effective date of CICA.

12. In light of the above, I am directing my staff to work with OFPP to develop revisions, not only to the "rule of two" FAR provisions, but also, as necessary to properly implement CICA, to the other FAR provisions discussed in the Brooks/GAO letter. I am asking Diane Weinstein of my staff to come up with a proposed revision to FAR 19-502-2 within the next 10 days.

cc: Arlene Triplett
Bill Mathis

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 11 1985

MEMORANDUM FOR JOSEPH R. WRIGHT

FROM: WILLIAM E. MATHIS Bill

SUBJECT: The "Rule of Two"

During our meeting Monday on the FAR "rule of two" provisions, you requested that I prepare a paper on the policy considerations surrounding the "rule of two" issue and also that we work with Mike Horowitz on the legal analysis of this issue. Attached is a point paper on the "rule of two" policy considerations. Also attached is the memorandum I furnished to Mike Horowitz containing our analysis of this issue. (Mike Horowitz advises me that he is the only OMB source for a legal opinion, therefore, Mr. Coleman's memorandum should be considered as a research paper, not a legal opinion.)

After having studied this issue carefully, I have concluded that the Congress did not intend to specifically legislate on the subject of when to set-aside an acquisition for exclusive participation by small business. However, what the Congress did legislate was an emphasis on the promulgation of regulations which require judgment in promoting full and open competition and the lowest reasonable cost to the Government.

Although the "rule of two," coupled with the other two criteria, is not intended to be used without the exercise of judgment, the perception by some is otherwise. For this reason, some modification of the regulatory language may be necessary to assure that contracting officers use sound judgment involving the adequacy of competition in making set-aside determinations.

Attachment

RULE OF TWO POLICY CONSIDERATIONS

- The "rule of two" is one of three criteria designed to implement set-aside programs under the Small Business Act in furtherance of the requirement that a fair proportion of Government contracts be placed with small business.

- The purpose of small business set-asides is not Federal largess to a certain economic sector. By assisting small business, we are also enlarging the industrial base and increasing competition for Federal contracts.

- The current FAR policy requires the contracting officer to make three determinations before deciding to set-aside an acquisition:

  1. There are at least two small business competitors that will compete (a reasonable expectation).

  2. They are responsible (can produce the quality required by the Government).

  3. Awards will be made at reasonable prices. (A contracting officer is not permitted, under a set-aside or otherwise, to make an award at an unreasonable price.)

- Agency program and technical offices are often distrustful of small business. This attitude is transmitted to contracting officers who must ultimately make the set-aside decision in support of the Small Business Act. Without clear and uniform policy guidance the contracting officers feel considerable pressure from the program offices not to make a set-aside for small business.

- The "rule of two," (properly called the "Rule of Two or More") along with the other two criteria, provides clear and uniform criteria for a contracting officer to use in deciding whether or not to make a set-aside.

- The terms "two or more" and "more than one" define competition for all Federal procurement. Therefore, the FAR provisions are merely stating that small business set-asides must be competitive. Contracting officers are not permitted under the set-aside program to limit the number of competing small businesses. By changing the traditional definition of competition from "two or more" to "sufficient number," there will be in effect a double standard for defining competition - one for small business (which will be nonstandard and imprecise) and another for all other Federal procurement.

- Agency heads are required by P.L. 95-507, to negotiate - with the SBA -annual goals for awards to small business. The establishment and achievement of these goals are carefully scrutinized by the House and Senate Small Business Committees. Set-asides are the principle means of assuring that proper awards will be made to small business in attempting to meet these goals.

- The SBA, the Small Business Committees, and the Agency small business representatives perceive that this change sends a signal to contracting officers that the small business set-aside program has been relaxed. It is emotional because they see it as a threat to the effectiveness of the program. (See attached SBA letter.)

- If it is determined that, as a matter of law, the words of the FAR must be changed to reflect the words in P.L. 98-369, such directive should contain additional guidance which emphasizes that contracting officers are charged with the responsibility to independently determine what constitutes sufficient competition and that two responsible contractors under appropriate circumstances may be sufficient.

Attachment

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 11 1985

MEMORANDUM FOR: WILLIAM MATHIS

FROM: William S. Coleman, Jr.

SUBJECT: Rule of Two

You have requested our analysis of the impact of the Competition in Contracting Act of 1984 (CICA) (P.L. 98-369) on Subpart 19.502-2, "Total Set-Asides," of the Federal Acquisition Regulation (FAR).

Analysis

Subpart 19.502-2 of the FAR establishes the "rule of two" as the threshold criterion for determining whether to set-aside a procurement action for exclusive small business participation. The pertinent FAR language is as follows.

> The entire amount of an individual acquisition or class of acquisitions ... shall be set-aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible, small business concerns offering products of different small business concerns; and (b) awards will be made at reasonable prices. Total set-aside shall not be made unless such reasonable expectation exists.

The FAR provision constitutes the executive branch implementation of Section 15 of the Small Business Act (15 USC 644), which requires that contracting agencies ensure that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns.

Congress' intent, as expressed in these provisions of the Small Business Act, is confirmed in recent amendments to the Federal Property and Administrative Services Act (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Procurement Policy Act (OFPP), as set forth in the CICA and the Small Business and Federal Procurement Competition Enhancement Act of 1984 (P.L. 98-577).

Section 2301(c) of the ASPA, as amended by CICA, states as Congressional defense procurement policy:

> (c) Further, it is the policy of Congress that a fair proportion of the purchases and contracts entered into under this chapter be placed with small business concerns.

This same Congressional Policy is set forth in Section 302 of the FPASA.

Sections 303(a) of the FPASA and 2304(a)(1) of the ASPA, as amended by CICA, require agencies to obtain "full and open" competition through the use of competitive procedures in conducting a procurement for property or services. As defined in the OFPP Act, as amended by the CICA (41 USC 414), "full and open competition" means that "all responsible sources are permitted to submit sealed bids or competitive proposals in a procurement." However, under CICA and P.L. 98-577, agencies are expressly permitted, in sections 303(b)(2) of the FPASA and 2304(b)(2) of the ASPA, to fulfill the requirements relating to small business concerns by using procedures which restrict solicitations to small businesses, so long as all such businesses are allowed to compete. The Conference Report (H.R. 98-361, page 1424) explained that the conferees sought to give more precise recognition to set-aside programs authorized by statute and that, in "recognition" of the Congressional policy of providing assistance to small business, agencies are authorized to limit competition to small business concerns only. Moreover, in defining competitive procedures, Sections 309(b) of the FPASA and 10 USC 2302(2) were further amended by P.L. 98-577, to include:

> Procurements conducted in furtherance of Section 15 of the Small Business Act (15 USC 644), [are considered competitive] as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete;

The question has now been raised regarding the appropriateness of the FAR "rule of two" set-aside procedures in light of Section 16 (Executive Agency Responsibilities) of the OFPP Act, as amended by CICA. The pertinent parts of Section 16 now read:

> Sec. 16. To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
>> "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".

Does the language in Section 16(1), which directs agencies to ensure receipt of "a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost ...," require that the provisions of the FAR 19-502.2 be revised accordingly?

It is clear that, by enacting this language, Congress intended agencies to apply a standard of lowest reasonable cost in procurement decisions, and the FAR should be revised accordingly. However, it is not clear that Congress intended that the

"sufficient number" language of the amendment eliminate or prohibit use of the "rule of two" as a threshold test in determining to set-aside a procurement for small business participation.

Under the current FAR procedures and the new FAR procedures which implement the CICA (effective April 1, 1985), the so-called "rule of two" is utilized as the threshold test in determining whether to set-aside procurements for small business. The contracting official must still apply the tests of "contractor responsibility" and "reasonable price" prior to executing a small business set-aside. Further, under the express language of the CICA, the contracting official must utilize competitive procedures among the small businesses.

The amendatory language of Section 16(1) was a conference substitute; the conference report includes a statement that: "This requirement applies to all agency procurements, including those made under set-aside programs." However, there is no reference in the legislative history that Congress intended to eliminate the "rule of two" as a regulatory procedure. In fact, Congress has specifically established a "rule of two" as the initial test for determining set-asides in small purchase procurements in Section 15 of the Small Business Act (15 USC 644(j)). Subsection 221(j) of P.L. 95-507 sets forth the following provisions:

> (j) Small purchase procedures
>
> Each contract for the procurement of goods and services which has an anticipated value of less than $10,000 and which is subject to small purchase procedures shall be reserved exclusively for small business concerns unless the contracting officer is unable to obtain offers from two or more small business concerns that are competitive with market prices and in terms of quality and delivery of the goods or services being purchased. In utilizing small purchase procedures, contracting officers shall, wherever circumstances permit, choose a method of payment which minimizes paperwork and facilitates prompt payment to contractor.

Although CICA directs improvement and simplification of small purchase procedures, the above provision of the Small Business Act has not been changed.

Conclusion

As indicated above, Congress has recognized the use of the "rule of two" in certain circumstances as the threshold test for initiating a set-aside. There are other situations in which the guidance is less clear, such as in the "sufficient number" language of Section 16 of the OFPP Act.

It appears, therefore, that the appropriate action under these circumstances would be to establish regulatory provisions which permit discretion by agencies to make set-aside determinations. Such discretion would not affect set-asides for small purchases under 15 USC 644(j), but would permit agency discretion in determining whether to set-aside after considering all pertinent factors; i.e., the nature of the requirement, the marketplace, ability to obtain the lowest reasonable cost, and the emphasis on carrying out the requirements of the small business statutes.

12-20
Maraist

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

JAN 11 1985

Mr. William Mathis
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Washington, D. C. 20503

Dear Mr. Mathis:

This is in response to your request that we provide comments on the impact of modifying the so-called "Rule of Two" found in Federal Acquisition Regulation (FAR), Section 19.502. As we understand it, the proposed modification would change the FAR language to require that the Contracting Officer determine that there is a reasonable expectation that offers will be obtained from a sufficient number of small businesses at the lowest reasonable cost to ensure free and open competition (emphasis supplied).

This change is thought by some to be indicated because they have concluded that the existing FAR 19.502 is inconsistent with the provisions of Section 2732(b)(2) of the Competition in Contracting Act. At the outset, this Agency takes the position that no such inconsistency exists. We believe that changing or eliminating the guidance to Contracting Officers by the Rule of Two about how to make the threshold decision to set a procurement aside is not dictated by the Competition in Contracting Act.

The proposed change would abolish the rule and result in no guidance at all to Contracting Officers. Based on our experience, we believe that the impact on the set-aside program would be devastating.

Both Congress and the Office of Management and Budget have recently concluded in the spare parts program that once a product or service becomes the exclusive domain of large business as a result of limiting sources and/or competition, the price increases on certain items are unacceptable. Thus, as a matter of public policy, Congress and OMB acted to increase small business participation in the provision of spare parts. By setting certain spare parts procurements aside for small businesses, uncontested savings of hundreds of millions of dollars have resulted. Those savings would be lost if the number of set-asides was reduced because of elimination of the rule.

It is an established fact that once a procurement is set aside, competition is increased. The Department of Defense averages 10 small businesses bidding on set-asides, the National

Aeronautics and Space Administration 12, and the General Services Administration more than 10. Unrestricted procurements do not bring this number of bids in most instances.

The Rule of Two effectively came into being in FY 1981. It was promulgated in July 1979, but because of distribution delays and changes did not have significant impact in FY 1980. Our analysis of DOD data reflects that increases attributable to the impact of the rule were 35.8 percent in FY 1981; 19.0 percent in FY 1982; 4.4 percent in FY 1983; and are projected at over 6 percent in FY 1984. These data reflect percentage increases in the small business share of the DOD procurement dollars in the set-aside program and are adjusted so that small purchase set-asides are not included.

Since the civilian agencies have only been subject to the rule since April 1984, and final FY 1984 data are not available from the Federal Procurement Data Center, we have made no attempt to analyze projected data.

We must conclude that since the above data reflect the greatest increase in small business participation in the program's history in DOD, elimination of the rule will result in substantially reduced set-asides.

This is not to say that the program is free of problems. We believe, however, that the effect of having no guidance to Contracting Officers as to when to set a procurement aside will adversely affect small business participation in Federal procurement programs. This will have the attendant effect of limiting growth in the industrial base encouraged in the Small Business Act and Public Law 98-577. Further, the return to the Treasury in taxes from small business is generally considered greater because many small businesses pay taxes as individuals without the more favorable corporate rates.

When using numbers to describe competition, the phrase "two or more" as found in Section 19.502 of the FAR is almost universally used. This can be misleading because in most instances there are far more than two small businesses interested in a given procurement. We think that the proposed language is too vague and that using another number would have little or no effect.

There are approaches which would provide a contracting officer flexibility in ensuring free and open competition while preserving the Rule of Two. We think that these alternatives should be examined in establishing policy concerning set-asides. We further believe other independent factors may operate with

the Rule of Two to produce undesired results in certain industries. We suggest an examination of those factors and their effect before eliminating the rule.

We would be happy to participate with the Office of Federal Procurement Policy and the two Councils in reviewing comments on the Rule of Two and working to achieve the goals of increased industrial capacity, free and open competition, and savings to the taxpayers.

Yours truly,

Rene Castillo Jr.

for James C. Sanders
Administrator

cc:
Official file - OFPP/PL&L
PL&L Chron
OFPP Reading File (2)
Mr. Coleman's Chron

OFPP:WSColeman:tjah 1/11/85

MEMORANDUM FOR: WILLIAM MATHIS

FROM: William S. Coleman, Jr.

SUBJECT: Rule of Two

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM

January 10, 1985

TO: Michael Horowitz

FROM: Diane Weinstein

RE: Rule of Two

Bill Coleman is finishing up a memo to Mathis on the Rule of Two legal issues. Mathis intends to use it as an enclosure to his memo to Joe Wright on the policy implications of changing the FAR to track CICA. Coleman says he will give us a draft of his memo to Mathis later today or tomorrow morning. At the Monday meeting Joe asked for Mathis' policy memo by tomorrow.

I spoke with Mary Ann Ferko and told her that, provided we get the Mathis and Coleman memos on schedule, we should have a response for Brooks by Monday.

Your idea to set a specified minimum number of bidders, with the burden on the contracting officer to show good cause (extraordinary circumstances) before reducing that number, sounds good. Since, according to Mathis, DoD and NASA usually have 10 or 12 bidders before doing a set-aside, why not use the lower of those two figures, i.e., ten. However, again, the change which will have the greatest implications is not raising the minimum number from 2 to 10, but rather incorporating the lowest reasonable cost standard.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM January 7, 1985

TO: Joe Wright

FROM: Mike Horowitz

RE: Rule of Two

The Washington Post's Federal Report item on Friday belatedly brought to my attention an issue which has apparently been percolating in the halls of OMB and OFPP for some time -- the legality of the "rule of two" now applied in set-aside decisions under new FAR 19.502-2.

After looking at the statute and its legislative history, I am convinced that the Brooks-Horton-Cohen-Levin view of the law is correct -- the rule of two is inconsistent with the new standard enacted by the Competition in Contracting Act of 1984, Title VII of the Deficit Reduction Act of 1984, P.L. 98-369 (CICA). Consequently, I propose a new approach to the matter, which would revise the offending FAR by simply reciting verbatim the new CICA standard. Such an approach would focus, not simply on whether the FAR rule of two should be replaced by the "sufficient number of bids" standard established in CICA but, more critically, on another, more important aspect of the controversy. That issue is whether the contracting officer must determine, not merely that the awards will be made at "reasonable rates" -- the current FAR standard -- but that they will result in awards "at the lowest reasonable cost," the second prong of the new CICA standards, which the legislative history explicitly makes applicable to set-asides.

The Small Business Act (15 USC 644) authorizes the use of set-aside procurement for small businesses when it is determined to be (1) in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) in the interest of war or national defense programs, (3) in the interest of assuring that "a fair proportion of total purchases and contracts for property and services for the Government are placed in small business concerns" or (4) in assuring that "a fair proportion of the total sales of Government property be made to small business concerns."

Revisions to the FARs were published in September, 1983 to be effective on April 1, 1984.

FAR 19.502-2 provides that an individual acquisition or class of acquistions "shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable rates." (Emphasis added.)

On March 14, 1984 Congressman Brooks wrote to the Director complaining that the "rule of two" set-aside provisions in the final FAR 19.502-2 rule (1) were not included in the version that went out for public comment and (2) violate the law.

Don Sowle's May 30, 1984 response to Brooks understandably focused almost exclusively on whether the FAR properly implements the Small Businesss Act, contending that the "issue is not the method of determining the existence of adequate competition among small businesses" but, rather, the propriety of set asides, which he felt had been resolved by Congress in the Small Business Act in favor of "non-procurement related public policies (socio-economic goals)."

CICA, Title VII of the Deficit Reduction Act of 1984, contains several provisions relating to competition in procurement, amending both the Federal Property and Administrative Services Act of 1949 and the Office of Federal Property Procurement Act.

The CICA amendment to Section 16 of the OFPP Act was a conference committee substitute. It mandates that executive agencies increase the use of "full and open competition" in procurement by "establishing ... procedures ... that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The conference report explains that this language is applicable when agencies are "using competitive procedures" and that the requirement "applies to all agency procurements, including those made under set-aside programs." (Note that old FPR 1-1.706-5 permitted total set asides under a "sufficient number" standard.)

The relevant CICA amendments to the FPASA are contained in Sections 303(b)(2) and 303(c). Section 303(b)(2) states:

> "In fulfilling the statutory requirements relating to small business concerns and socially and economically disadvantaged small business concerns, an executive agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to compete."

Sections 303(c), which lists the occasions when an agency may use other than competitive procedures, does not except small business set-asides.

Although there is no explicit reference to replacing the "rule of two" in the statute or its legislative history, the appended joint letter of Senators Cohen and Levin and Congressmen Brooks and Horton asserts that the "rule of two" provision "runs contrary to" Section 16 of the OFPPA.

On the other side, Congressman Mitchell maintains that the rule of two is per se competitive under current law, citing Section 303(a)(2) of FPASA and the parallel Section 2304(a)(2) of the Armed Services Procurement Act. Section 303(a)(2) of FPASA states that in determining the competitive procedures appropriate under the circumstance, an executive agency is required to solicit sealed bids if:

> "(A)(i) time permits the solicitation, submission, and evaluation of sealed bids;
>
> (ii) the award will be made on the basis of price and other price-related factors;
>
> (iii) it is not necessary to conduct discussions with the responding sources about their bids; and
>
> (iv) there is a reasonable expectation of receiving more than one sealed bid; and
>
> (B) shall request competitive proposals if sealed bids are not appropriate under clause (A).

Of course, Section 303(a)(2)(A) relates to the standards for soliciting sealed bids, and not to whether the procedure as a whole is competitive, as is clear from reading the immediately following subsection (B), which requires "competitive proposals" when sealed bids are not appropriate. In any event, it is clear that the numerical aspect of the rule of two was never the sole standard for competiveness; in addition, there had to be the likelihood of obtaining a reasonable rate.

Clearly, in many instances competitiveness (the lowest reasonable cost) may be assumed on the basis of only two bids. However, the crucial test is competitiveness, not some arbitrary number greater than one. Therefore, what I would propose to do would be merely to substitute "lowest reasonable cost," the newly-mandated Congressional standard, for "reasonable rate."

Proposed FAR revisions:

> "19.502-2 Total set-asides.
>
> The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business -- small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from *a sufficient number of* responsible small business concerns offering the products of different small business concerns and (b) awards will be made *at the lowest reasonable cost*. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as to partial set-aside).
>
> 19.502-3 Partial set-asides
>
> (a) The contracting officer shall set aside a portion of an acquisiton, except for construction, for exclusive small business participation when ---
>
> (1) ....;
>
> (2) ...;
>
> (3) *A sufficient number of* small business concerns are expected to have the technical competence and productive capacity to satisfy the set-aside portion of the requirement *at the lowest reasonable* cost;
>
> (4) ...; and
>
> (5) .

(Revisions are indicated
by underscoring.)

OFFICE OF THE UNDER SECRETARY OF DEFENSE
WASHINGTON DC 20301-3051

RESEARCH AND
ENGINEERING
(AM)

31 DEC 1984

Mr. William Maraist
Office of Federal Procurement Policy
Office of Management and Budget
726 Jackson Place
Washington, D.C. 20503

Dear Mr. Maraist:

The following is submitted on behalf of the Department of Defense in response to your Federal Register Notice Vol. 49, No. 199 of October 12, 1984 seeking comments on the "rule of two or more."

To accomplish the purpose of the Small Business Act, Congress authorized the use of a set-aside procurement method for any contract (or part of a contract) whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns..." It should be noted that the first two justifications deal with benefits that accrue not to the small business community but rather to the Government (underscoring added.)

The only mechanism available to carry out this Congressional mandate is through the small business set-aside program, which serves as the underpinning of the Federal agencies small business programs.

FAR subsection 19.502-2 represents our best efforts to comply with the direction of Congress to support the small business community. Our procurement regulations establish procedures for both total and partial small business set-aside programs (FPR 1-1.706; DAR 1-706; NASA PR 1.706). These have worked effectively for almost thirty years to enhance the opportunities for small business and small disadvantaged business firms to participate in the acquisition of products and services by Federal agencies.

Enclosure

Current FAR coverage at 19.502-2 gives the Executive Agencies a precise formula for deciding when to use a small business set-aside. Until the procurement regulations were amended to include the "rule of two or more," as a firm standard, the only measure for deciding to make a small business set-aside was whether there was "a reasonable expectation" that a "sufficient number" of responsible small business firms would submit offers "at reasonable prices." The "sufficient number" standard was open to broad interpretation and proved inadequate; there was inconsistency of application from one contracting office to another within any given agency and certainly across the Federal Government.

The initial version of the FAR (Phase I) circulated for comment did not reflect the "rule of two or more" because it was based on the Federal Procurement Regulation (FPR) that enunciated only the "sufficient number" criterion. Virtually all the public comments received on FAR 19.502-2 (including those of DoD, GSA, NASA, and SBA) requested it be amended to include the "rule of two or more." There were two main concerns reflected in the commentors' remarks. The "rule of two or more" is required to be followed in placing small purchases in accordance with P.L. 95-507. It is logical to follow that policy for other procurements if procuring agencies are to accomplish the mandate of the Armed Services Procurement Act of 1947, the Federal Property and Administrative Services Act of 1949, the Competition in Contracting Act of 1984, and the Small Business Act;-i.e., to ensure that small businesses receive a fair share of the total of Federal contracts. Secondly, the old "sufficient number" standard is difficult to interpret, leaving the decision to thousands of buyers and contracting officers throughout the entire Federal establishment. This produces confusion not only for procurement personnel but also for the Small Business Administration and for the thousands of small business and small disadvantaged business firms throughout the country which support the various procuring agencies of the Federal establishments. This confusion resulted from the lack of knowledge and consistency of application as to what was the precise quantification of the sufficiency of expected responses from the small business community to justify the setting aside of a procurement for exclusive participation by small business firms.

Our surveillance reviews showed that in numerous cases contracting officers did not set aside a procurement for small business when their bidder's mailing lists contained in excess of 15-20 small firms that had registered a capability to provide a required product or service. For example, this

situation resulted in DoD's set-asides averaging only approximately 6% of its annual expenditures with U.S. business firms. Within the Department of Defense, the Navy Department had established the "rule of two or more" in their Navy Procurement Regulations (NPR) in 1964. With the passage of the Amendment to the Small Business Act (Public Law 95-507) and the requirement to revise the Defense Acquisition Regulation (DAR) to include the provisions of this amendment, the DoD reviewed the Navy's rule of two or more for DoD-wide application and codification in the DAR. This review indicated that competition is binary, - it exists or it does not, - or more specifically, a solicitation/contract award is either sole source or it's competitive. DoD, like other Federal agencies, records awards as being competitive whenever offers are received from two or more business firms. Accordingly, the test of sufficiency of competition to set-aside a procurement for exclusive participation by small business firms is satified when there is reasonable expectation that offers will be received from two or more small business firms. We do not believe we should have one standard for measuring competition for non-small business set-asides and a different standard as to what constitutes competition necessary for a small business set-aside.

Codification of such sufficiency of competition was included in the DAR on July 27, 1978 and has contributed to increasing the rate of set-asides to only 10.0% in FY 1984 ($112.5 billion or 90.0% of DoD's total awards of $124.9 billion were made by other than small business set-aside).

It should be noted that DoD alone processed 14.8 million procurement actions during FY 1984. The majority of these actions were processed by automated procurement systems. In the design of such systems the old approach of using the term "sufficient" could not be used, quantification was and is mandatory in the establishment and operation of these automated procurement ordering and reporting systems. It should also be noted, there have been several Comptroller General cases which have substantiated the legality of this policy.

We would like to note that small business set-asides generally result in more, not less competition. This increase in competition results because of two factors: (1) there is a much larger number of small business firms than big business firms; (2) the small business community perceives that when a procurement is set-aside, it, by definition, can not be a sole source award and that they will be competing against their peers and therefore stand a realistic chance of winning the contract.

The practice of setting aside procurements for small businesses has long been accepted as Congressional policy and that of past and present Administrations. It should also be noted, there have been several Comptroller General cases which have substantiated the legality of this policy. Thus, the FAR merely continues a long-standing practice of partial and total set-asides. However, the FAR settled on language that was consistent with the DAR and NASA Procurement Regulations to eliminate the problem being experienced under the Federal Procurement Regulations (FPR) as to how many firms constituted a "sufficient number" to warrant a set aside. Therefore, the current FAR language only represents new policy for former FPR users of the Federal civilian agencies other than NASA. It reflects a policy that has been in effect for over 20 years in the Navy, almost five years DoD-wide and approximately one and one-half years at NASA.

The published version of the FAR reflects the negotiated agreement between the three procurement regulatory agencies, (DoD, GSA, and NASA) to arrive at a workable standard for small business set-asides in order to provide for the required consistency of application needed across the Federal government. We do not view the FAR language as permitting one economic group to take over the Federal market place. Small business set asides are used to attain the small business participation goals set pursuant to Public Law 95-507 (15 U.S. 644), and not to deprive large business of its share or to unduly limit the competitive field. We do not feel that the FAR language violates current law but rather that it reflects the will of Congress as expressed in the Small Business Act.

In summary, FAR 19.502-2 was written to conform to the public comments received when the first version of the FAR was circulated and, as previously stated, is in furtherance of the mandate to ensure that small business receive a fair proportion of Government contract awards. In view of this, we see no valid reason to change the FAR language.

Sincerely,

Eleanor Spector

ELEANOR R. SPECTOR
ACTING DEPUTY UNDER SECRETARY
(ACQUISITION MANAGEMENT)

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15 DEC24

CE UNIT

December 20, 1985

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

As you know, we strongly believe that the Federal procurement process should be made more competitive, so that agencies will receive the best appropriate goods and services at the lowest possible overall cost. The Competition in Contracting Act, enacted last year on our recommendation in Public Law 98-369, makes full and open competition the standard for Federal procurements.

A number of statutes and regulations, however, still interfere with appropriate implementation of this Act, and consequently deprive our citizens of the opportunity to get the best buys for their tax dollars. Prominent among these regulations is the "rule of two," which permits agency officials to set a contract aside for award only to a small business whenever the officials think that two or more small firms might want to perform the work. Once a contract is set aside, any efficient company which is larger than the size established under Small Business Administration regulations may not be awarded that contract--even if it can do the work better, and at a lower price, than a small firm can.

This "rule of two" was inserted into the Federal Acquisition Regulation without public comment prior to enactment of the Competition Act. It is clearly inconsistent with the spirit of that law. Furthermore, it has no basis in statute. In fact, in the same year that Congress approved the Act, the House of Representatives, at the urging of numerous committee chairmen and ranking minority members, chose not to consider a bill whose principal provision would have given statutory authority to the rule.

When the Competition Act became effective last April, the FAR should have been amended to bring the "rule of two" into conformity with the Act. Despite the inconsistency between the Act and the rule, and despite the numerous public comments which the Office of Federal Procurement Policy received in opposition to the rule at the end of 1984, the FAR still has not been amended.

We urge you and the OFPP to replace the rule with regulations which comply with the Competition Act and therefore further an objective which you and we share: achieving better buys through increased competition in Federal procurement.

Sincerely,

Jack Brooks
JACK BROOKS
Chairman

Frank
FRANK HORTON
Ranking Minority Member

22058

Identical letters sent to
Allan Burman, GSA
and [illegible]
Evans, NASA

Congreſs of the United States
Washington, D.C. 20515

December 12, 1984

see p. 4

Joint letter
from Cohen/Levin
and Brooks/Horton

Ms. Mary Ann Gilleece
Deputy Under Secretary of Defense
(Acquisition Management)
Room 3E144
The Pentagon
Washington, D.C. 20301-3060

Dear Ms. Gilleece:

As you know, the General Accounting Office has established an interdivisional procurement task force, at our request, to oversee both the regulatory implementation of and subsequent agency compliance with the Competition in Contracting Act (CICA), P.L. 98-369.

The GAO task force recently completed its initial review of the proposed CICA changes to the Federal Acquisition Regulation and found that the proposed regulations generally reflect the statute, except for the problem areas discussed below.

In these areas, the GAO task force found that the proposed regulations either do not comport with the statutory requirements or do not provide sufficient guidance, thus inviting unnecessary supplementation. The discrepancies between legislative intent and executive implementation result, in almost all cases, from an apparent disregard for the Conference Report (98-861), which gives direction to those responsible for issuing the regulations.

We are concerned that, unless revisions are made to the proposed regulations, the purpose of CICA -- to enhance competition and strengthen the restrictions on unnecessary sole-source contracting -- will not be fully realized.

The following is a preliminary list of proposed FAR provisions which we strongly believe need revision in order for the regulations to be compliant with the statute. These changes should be incorporated in the regulations before they are issued in final:

- FAR 6.302-1(b) cites examples in which the first exception to the requirement for full and open competition may be used. Under the first example (FAR 6.302-1(b)(1)), however, the condition for going sole-source -- "the required supplies or services are available from only one source" -- is clearly less restrictive than the statutory exception, which requires as a further condition that no other type of property or services will satisfy the agency's needs.

- The treatment of follow-on contracts and unsolicited proposals -- listed as the second and third examples, respectively, under the first exception -- is equally troubling. As currently written, these examples do not limit the sole-source award in either case to the conditions specified in CICA. Since the proposed regulations state that the list of examples is "not intended to be all inclusive," a contracting office may attempt to justify a sole-source award of follow-on contracts or unsolicited proposals unrelated to the specified conditions, which is not authorized under CICA.

- The remainder of examples under the first exception seek to create broad categories for sole-source award which are not authorized under CICA. Determinations and decisions required to use this exception are to be made on a case-by-case basis pursuant to the criteria provided. See related problem with FAR 6.303-1(c).

- The FAR provisions do not reflect our intent, as expressed on page 1426 of the Conference Report, that noncompetitive follow-on contracts are to be limited to those awarded after (1) an original competitive award and (2) a cost-benefit analysis is conducted to determine and document whether the initial capital investment could cause substantial duplication of cost if the contract were awarded to other than the original source, or whether such cost could be offset by savings resulting from competition.

- FAR 6.302-1(c)(2) provides that for contracts awarded under the first exception, the notices required by FAR 5.201 "shall have been published and any bids or proposals must have been considered." The FAR, does not, however, provide additional guidance regarding what constitutes "consideration." The Conference Report states on page 1427 that "agencies should, at a minimum, give each bid or proposal...sufficient consideration so as to be able to make an informed judgment about the responsibility of the bidder and the responsiveness of the bid."

- Under CICA, an executive agency may not "procure property or services from another executive agency unless such other executive agency complies fully with the requirements of this title." This provision is included, according to page 1428 of the Conference Report, "to prevent one agency from acquiring its goods and services from another agency's sole-source contract without having to justify a noncompetitive procurement itself." FAR 6.303, which covers the justification requirements for using procedures other than competitive procedures, should incorporate that provision.

- FAR 6.303-1(c) permits justifications relating to the first six exceptions from competitive procedures to be made on a class basis. Again, this provision runs contrary to our stated intent that "all determinations and decisions required for use of the exceptions to competitive procedures...are to be made on a case-by-case basis. Broad categories or classes of products and services cannot be exempt from competitive procedures." See page 1427 of the Conference Report.

- FAR part 7 deals with acquisition planning. The predominant emphasis seems to be on acquisition planning for relatively complex or high-dollar procurements. We believe that this part should be revised to provide guidance for other than complex or high-dollar procurements. The Conference Report states on page 1429 that the planning requirements in CICA apply to all procurements -- competitive and noncompetitive.

- FAR 10.002(6) requires that defense agencies include descriptions of agency requirements, whenever practicable, to be stated in terms of functions to be performed or performance required. This preference for functional or performance specifications over detailed design specifications is applicable government-wide, rather than just to defense agencies.

- FAR 13.000(a) provides for a $10,000 small purchase threshold for civilian agencies, which was increased to $25,000 under the Office of Federal Procurement Policy Act Amendments of 1983 (P.L. 98-191). Below this threshold, FAR 13.103(a) states that small purchase procedures shall be used to the maximum extent practicable. This provision fails to emphasize CICA's requirement that "in using small purchase procedures, an executive agency shall promote competition to the maximum extent practicable." The regulation should reflect that requirement.

- FAR 15.804-2(a)(2) states that there are "relatively few instances" where certified cost or pricing data and inclusion of defective pricing clauses would be justified in awards between $25,000 and $100,000. While certified cost or pricing data are not required for negotiated contracts under $100,000, contracting officers are authorized under CICA to obtain such data and should not be discouraged from doing so, especially considering the spare parts problems.

- For contracts under $25,000, moreover, FAR 15.804-2(a)(2) states that "the contracting officer shall not require certified cost or pricing data." This prohibition simply has no basis in statute.

- FAR 15.5, which deals with unsolicited proposals, needs to be revised to (1) limit noncompetitively awarded unsolicited proposals to those involving research, (2) define or provide guidance for applying the concept of "unique" referred to in 15.502, 15.503(c)(1), 15.506-2(a)(1), 15.507(a)(3), etc., and (3) place limitations on information that may be disclosed to only one or a few select potential contractors when others could also meet the agency's needs.

- FAR 19.502-2 retains the "Rule of Two" provision, which we believe is no longer appropriate under CICA. The minimal standard for competition established by the "Rule of Two" provision runs contrary to section 16 of the Office of Federal Procurement Policy Act, as amended by CICA, which requires agencies "to increase the use of full and open competition...by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or proposals from responsive sources..." The Conference Report clearly states on page 1434 that this requirement applies to "all agency procurements, including those made under set-aside programs."

- The FAR does not incorporate the record requirements in CICA, which amend section 19 of the Office of Federal Procurement Policy Act. These provisions are required to be implemented on a government-wide basis.

- Finally, the proposed FAR changes, of course, need to be revised in accordance with the provisions of P.L. 98-577 and P.L. 98-525.

In addition to these problem areas, attached is a list of other issues which the GAO task force believes need revision.

Given the size and importance of the task, we commend the Defense Acquisition Regulatory Council and the Civilian Agency Acquisition Council for their diligent efforts.

We appreciate your continued cooperation, and request that you provide us with your specific plans to revise the regulations.

Sincerely,

William S. Cohen, Chairman
Subcommittee on Oversight of
Government Management
Senate Committee on Governmental Affairs

Jack Brooks, Chairman
House Committee on Government Operations

Carl Levin
Carl Levin
Ranking Minority Member

Frank Horton
Frank Horton
Ranking Minority Member

Attachment

cc: Mr. James T. Brannan, Director
Defense Acquisition Regulatory Council

ATTACHMENT ATTACHMENT

ADDITIONAL ISSUES RELATING TO THE FAR REGULATIONS IMPLEMENTING CICA

1. FAR 5.002 (page 12). Suggest deleting the phrase "offering competitive opportunities for contractors and subcontractors." This phrase has been widely interpreted by contracting officials as requiring publicizing of contract actions only when they decide that competitive opportunities exist. (See GAO/PLRD-82-40, especially pages 30 and 31.)

2. FAR 5.202(a)(1) (page 13). Suggest revision to provide for the exception when "the synopsis for a contract action cannot be worded to preclude the disclosure of information which would compromise the national security. The fact that a contract action involves classified information does not, in itself, justify an exception."

3. FAR 5.202(a)(7) (page 13) needs clarification. Do the last four lines apply to proposals under SBIDA, too?

4. FAR 5.203(c) (page 14). Suggest that the words "unilateral sole-source" be eliminated.

5. FAR 5.301, line 4 (page 16). Suggest adding "any" before the word "subcontracts," per CICA, section 2732, amending section 18(a)(1)(B) of the OFPP Act.

6. FAR 6.003 (page 19). Suggest revising the definition of full and open competition by adding the words "submit sealed bids or competitive proposals and" before the word "compete".

7. FAR 6.303-2(a)(6) or (8) (page 23). Suggest adding at the end of this provision such words as, "including whether a CBD notice was publicized as required by FAR 5.2 and, if not, which exception under 5.202 applies." Otherwise, when publication of a CBD notice is not mentioned in the justification, reviewers will not know from reading it whether such notice was publicized.

8. FAR 6.303-2(9)(ii), line 2 (page 23). Suggest adding "to the government" after "cost". (See FAR 6.302-1(b)(2) and CICA sections 2711 and 2723(d)(1)(B).)

9. FAR 6.304(a)(1) (page 23). Suggest that the floor (i.e., the lowest dollar amount) to which this requirement applies, presumably $25,000, also be cited.

10. FAR 7.101 (page 25, definition of market survey). It is not clear how the phrase "and the results of any market test recently undertaken" fits in. Suggest wording clarification.

11. FAR 8.403-2 (page 33). Contained a FAR revision adding a new second sentence, "All responsible offerors may submit offers in response to a solicitation for multiple-award schedule contracts." But the FAR instructions deleted this revision. Suggest that this revision be retained. (See CICA section 2711 amending FPASA section 309(b)(3) and CICA section 2721 amending 10 U.S.C. 2302(2)(C).) It is not clear why this revision was deleted.

12. Has FAR 9.2 (pages 34 and 35, revised) and FAR Part 11 (starting on page 39, revised) been revised to be consistent with Public Law 98-577 and, to the extent appropriate, the DOD fiscal year 1985 authorization act?

13. FAR 10.002(a)(4) (page 37). Obviously, something is missing here.

14. FAR 13.103(b), last line (page 42). Suggest "the use of" replace the words "negotiation under".

15. FAR 13.204(c) (page 45, revised). Suggest the proposed FAR revision be deleted. The earlier wording appears to be more appropriate.

16. FAR 14.101(e) (page 49). Suggest the "and" before "other factors included" be deleted.

17. FAR 14.103-2 (page 49). Suggest "unless" be added after sealed bidding.

18. FAR 14.104, line 2 (page 49). Suggest changing "formal advertising" to "sealed bidding". Also see FAR 14.501, line 2 (page 65).

19. FAR 14.201-7(b)(1), line 1 (page 52). Suggest adding "sealed bidding" after "by".

20. We could not find some of the information in FAR references. For example:

—FAR 14.203-1 (page 55) refers to 5.102(c)(1).

—FAR 14.404-1(e)(1) (page 59) refers to 15.103, which is "reserved".

--FAR 36.103(a) (page 143, revised) refers to 6.003(a) and 6.003(b)(2).

—FAR 36.601 (page 147, revised) refers to 6.102(c)(1).

—FAR Subpart 38.1 (page 150, revised) shows a paragraph (c) to be inserted (but it does not indicate where). The insert refers to FAR 6.103.

21. FAR 15.502 (page 75). FAR policy only addresses unsolicited research proposals, but the definition of unsolicited proposal is not limited to research. (Also, see comment number 1 on page 1 and comment number 11 on page 9, above.)

22. FAR 15.503(c)(5) (page 75). The meaning of "documented" is unclear. Will this wording permit noncompetitive awards simply because known requirements were not "documented" in some specific way defined by agencies' internal procedures?

23. FAR 15.1001(a) (page 96). Suggest adding the word "promptly" before "notify". (See CICA, section 2711 amending FPASA section 303B(d)(4) and CICA section 2723 amending ASPA section 2305(b)(4)(D).)

24. Should FAR 17.6 be revised based on CICA? For example, see 17.604(c).

25. FAR 19.502-4(a) (page 114). Suggest "Whenever possible" be changed to "Whenever appropriate".

26. FAR 34.002(b) and FAR 35.005-1(a) (page 139). Suggest that the references to "effective" competition be deleted (while retaining the references to Part 6 and full and open competition).

27. FAR 44.302(a) (page 153) deletes some wording relating to modifications. It is not clear why.

28. FAR Part 52, table of contents, item 52.214-3 (page 162). Why is "Invitations for Bids" changed to "Request for Sealed Bids"?

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

DEC 6 1984

MEMORANDUM FOR: JOE WRIGHT

FROM: Don Sowle Don

SUBJECT: Your note on the "Rule of Two" Regulations

The architect-engineer (A-E) community is currently engaged in a concerted effort to change the FAR "rule of two" which requires small business set-asides when there are two or more small businesses eligible to compete and reasonable prices will result. The A&E's are particularly concerned because over 97% of all A-E firms (some 30,000 in number) are classified by SBA as small businesses. Those concerned with the rule of two are interested in reducing the number of small business set-asides, but this is difficult because nearly the entire industry is classified as small and the competition is keen. The A&E's have been unsuccessful in convincing SBA to change the size standard so they are attacking the problem indirectly by zeroing-in on the "rule of two".

This "rule" was developed to implement the Small Business Act requirement that a fair proportion of total purchases be placed with small business concerns. The majority of the dollars go out for major systems for which small firms cannot compete. Therefore, to achieve a fair proportion of total sales, agencies must concentrate on those products and services where small businesses are competitive.

The "rule of two" is currently in the FAR because the procuring agencies, the SBA, the Small Business Committees, the GAO and the courts all are in agreement that it is an appropriate implementation of the Small Business Act. It also has been successful for many years in DOD.

Some facts you should know:

- We are requesting public comment because of complaints that the FAR process did not properly air this issue.

Joe, To put this in perspective, A+Es are only about 45% of the set-aside program. 11/[illegible]

- We extended the comment period at the request of Congressmen Parren Mitchell and Berkley Bedell to give small business a fair opportunity to comment.

- Some Congressional staff say that the Competition in Contracting Act and the Conference Committee Report settled the issue. In our response to Congressmen Mitchell and Bedell we asked for a statement of Congressional intent from the Conference Committee participants.

Our present position is that, although we support the rule of two or more, we will wait until after the public comment period to evaluate all comments. We will also wait for a response from Congressmen Mitchell and Bedell on the impact of the Competition in Contracting Act on the rule of two.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Rule of Two /
SCAT
[illegible]

MEMORANDUM December 4, 1985

TO: Jack Carley

FROM: Diane Weinstein DW

SUBJECT: Rule of Two

Joe Wright would like us to meet this week with him and Bill Mathis of OFPP on an issue that has been kicking about for some time now -- revision of the "rule of two," which is applied in making small business set-aside decisions under the Federal Acquisition Regulation (FAR) system.

Jack Brooks; his ranking minority member, Frank Horton; and their counterparts on the Senate Governmental Affairs Committee (Senators Cohen and Levin) have long (since the Competition in Contracting Act was enacted in July 1984) contended that the rule of two was made unlawful by CICA's amendment to the OFPP Act. See Attachment "A", letter from Brooks and Attachment "B", a joint letter to Mary Ann Gilleece from Brooks, Horton, Cohen and Levin, at p. 4.

We have agreed with Brooks et al. See January 15, 1985 Horowitz memo to Joe Wright (Attachment "C") and letter to Senator Heinz (Attachment "D").

The three principal procurement agencies (DoD, NASA, GSA) responded to the joint letter indicating no plan to take action to eliminate the rule of two in the final rules to implement CICA in the FAR, which are scheduled to be issued in February. Therefore, Joe requested options by which OMB or OFPP could require such implementation. These are set out in my memo of Oct. 1 (Attachment "E".) I have drafted an OFPP Bulletin to implement option III.3. in that memo. (Attachment "F").

The attached material should acquaint you with the principal legal issues. I assume Joe wants to discuss both legal and ~~policy~~ issues at our meeting.
tactical

Attachments

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

NOV 6 1984

MEMORANDUM TO "RULE OF TWO" COMMENT FILE

FROM: BUD MARAIS

SUBJECT: Record of telephone comment from Jim Lewin on November 1, 1984

Jim Lewin called to ask why we published the "rule of two" in the Federal Register for comment. It is his view that the CICA settled the issue.

Jim pointed out the following section in the amendments to the OFPP Act, as well as the corresponding section in the conference report:

> (2) Section 16(1) of such Act (41 U.S.C. 414(1) is amended to read as follows:
> "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives "a sufficient number" of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".
>
> "The conference substitute amends Section 16(1) of the OFPP Act (executive agency responsibilities) to require the use of full and open competition in executive agency procurements of property and services. Language contained in this substitute requires agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs."

He said that it was the conferee's view that the "rule of two" should be replaced by a concept of a sufficient number to fulfill requirements at the lowest reasonable cost. This represents a flexible standard that could vary from product to product or service to service. Each proposed set-aside should be evaluated using a standard evaluation that goes to heart of the issue - and that is, "will the resulting competition produce the lowest reasonable cost to the Government?" He feels that having a fixed number (2) standard does not do that.

OCT 31 1984

Honorable Parren J. Mitchell
Chairman, Committee on Small Business
U. S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Thank you for your letter of October 18, 1984 concerning the "rule of two."

As you noted, the Office of Federal Procurement Policy believes that the FAR language which establishes the requirements for setting aside procurements for small business complies with current law and reflects the will of Congress as expressed in the Small Business Act. This opinion has been communicated to all who have inquired about the "rule of two." The Federal Register notice on October 12, 1984, was not intended to convey concern about the legality of the "rule of two." Rather, our concern, and that of the Administration, is to ensure that procurement policies work to support the requirement that small business receive a fair share of total Federal contracts. OFPP did not selectively choose this provision for further comment. The notice was published because 19 Congressmen and 11 Senators have written to the Director of the Office of Management and Budget (OMB) or to me with the complaint that this provision of the FAR was included without adequate opportunity for public comment. Their complaint is based on the fact that the FAR language initially tendered for public comment contained the "sufficient number" standard as opposed to the "rule of two." Those who favored the "sufficient number" standard state that they did not comment because they concurred in the proposed language. Each of the 19 Congressmen and 11 Senators requested that the issue be reopened for public review and comment.

We believe that those who wrote to us expressed a legitimate and reasonable concern which warrants this additional opportunity for comment. This office has always stood for the proposition that Federal procurement policy development should always be open to public scrutiny and comment. Even though we believe the FAR "rule of two" complies with current law, we must be open to hear fully the views of the private sector.

The statement in the Federal Register notice regarding small business receiving a disproportionately high share in some categories of procurement was merely a statement of fact and not in any sense an expression of concern by OFPP. We have always worked very closely with the Small Business Administration to ensure that the interests and needs of small business are given every consideration. In this case, since the alleged problem, if there was one, seemed to stem from the size standards rather than from any procurement policy, we discussed our proposed notice with SBA representatives responsible for the size standards. We did not feel that further coordination was necessary inasmuch as we are not proposing a policy change. We also discussed the matter with DOD, GSA and NASA.

We do not believe there are any procurement policy issues that should be off-limits to the Office of Federal Procurement Policy except those limitations established by law. Certainly the fairness, effectiveness or legality of all procurement policies and regulations are of legitimate concern to the OFPP.

You have requested that the notice for comment be immediately rescinded. In view of the interest expressed by thirty Congressmen and Senators in receiving public comment as well as our longstanding commitment to be open to the public, I cannot agree to rescind the notice.

Sincerely,

Donald E. Sowle
Administrator

cc:
OFPP File/Chron/Reading
Mr. Maraist Gordon Wheeler
Mr. Sowle
Five recipients of letter
OFPP:WMaraist:mbd 10/26/84 Log #: 84-566

Identical letter to:
Hon. Berkley Bedell
Chairman, Subcmte on General
Oversight and the Economy

PARREN J. MITCHELL, MD., CHAIRMAN
NEAL SMITH IOWA
JOSEPH P ADDABBO N Y
HENRY B GONZALEZ TEX
JOHN J LAFALCE N Y
BERKLEY BEDELL IOWA
HENRY J NOWAK N Y
THOMAS A LUKEN OHIO
IKE SKELTON MO
CHARLES W STENHOLM TEX
ROMANO L MAZZOLI KY
NICHOLAS MAVROULES MASS
CHARLES HATCHER GA
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DENNIS E ECKART, OHIO
GUS SAVAGE, ILL
BUDDY ROEMER, LA
NORMAN SISISKY VA
ESTEBAN EDWARD TORRES CALIF
TOM J VANDERGRIFF TEX
JIM COOPER, TENN
JAMES R "JIM" OLIN VA
C ROBIN BRITT, N C
RICHARD RAY, GA
CHARLES A HAYES, ILL

Congress of the United States
House of Representatives
COMMITTEE ON SMALL BUSINESS
2361 Rayburn House Office Building
Washington, D.C. 20515

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MAJORITY—225-5821
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AREA CODE 202

ECEIVED OFPP
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84-56,
Doug
due 11/2

October 18, 1984

Honorable Donald E. Sowle
Administrator
Office of Federal Procurement Policy
726 Jackson Place, N.W.
Washington, D.C. 20503

Dear Mr. Administrator:

On October 12, 1984, the Office of Federal Procurement Policy (OFPP) published a "Notice of Comment" in the Federal Register regarding the so-called "rule of two" for small business set-asides.

It is our understanding that your office did not consult with nor inform the Small Business Administration (SBA) prior to this publication. As you know, similar lapses have occurred in the past and we would, once again, express our desire that you work more closely with the SBA.

We find it somewhat curious that you should select this one provision for further comment out of the nearly 700 pages of regulations which now comprise the FAR. We have tried unsuccessfully to understand OFPP's motive for this selective exercise of its authority.

We do not believe that OFPP should be legitimately concerned about small business receiving a disproportionately high share of the prime contract dollar. According to recently available statistics, while small business accounts for over 99% of all businesses in this country, they receive only about 18% of the prime contract dollar. Big business — 1% of all firms — is, therefore, receiving over 80% of the dollar. Surely, the review which OFPP has initiated could not be motivated by a desire to curtail further the share of the contract dollar captured by small business.

Similarly, we do not believe that OFPP should be legitimately concerned about the "rule of two" being an untried approach to small business set-asides. The "rule of two" has been used by the Navy since 1964; by the entire Department of Defense since 1979; by NASA since 1982; and by all other agencies since April 1 of this year. This test of competition has twenty years of empirical evidence supporting its use. OFPP could not, of course, be intent upon summarily disposing of a test for sufficient competition that has also withstood the "test of time."

In addition, we do not believe that OFPP should be legitimately concerned about the effectiveness of the set-aside program. Once again, the statistics would belie any such doubt. In fiscal year 1981, 43.08% of all government awards to small business were effected through the set-aside program; in FY 1982, the comparable percentage increased to 45.19%; and in FY 1983 to 48.96%. For military purchases, small business is even more dependent on set-asides. In FY 1981, 46.66% of the small business share of DoD awards were made through set-asides; in FY 1982, 49.75%; and in FY 1983, 51.3%. Statistically, therefore, if a small business is selling to the DoD it is more likely than not that the contract was a set-aside. We trust that OFPP would not, therefore, do anything that would have the effect of weakening a program upon which small business is so highly dependent.

Moreover, we do not believe that OFPP should be legitimately concerned about the legality of the "rule of two." In fact, in the OFPP Notice of Comment you state: "We believe that the FAR language complies with current law and reflects the will of the Congress as expressed in the Small Business Act. This method of implementing the fair proportion of total contracts has been upheld by the courts and the Comptroller General." In fact, if you should require a more recent expression of the Congress to support your own statement, you need look no further than the Competition in Contracting Act (P.L. 98-369) and recent amendments to that Act contained in H.R. 4209, the Small Business and Federal Procurement Competition Enhancement Act of 1984 (P.L. 98-). Under both those Acts, small business set-asides are considered competitive procurement procedures. Pursuant to section 303(a)(2) of the Federal Property and Administrative Services Act of 1949 and section 2304(a)(2) of the Armed Services Procurement Act, the head of an agency must use competitive procedures if, among other things, "there is a reasonable expectation of receiving more than one sealed bid." How could there possibly be different tests for set-asides and unrestricted procurements when both are legally considered competitive procedures?

Succinctly stated, we believe your Notice of Comment is ill-advised and ought to be immediately rescinded. There appears to be no basis in either law or fact to isolate this particular provision of the FAR for further public comment. We trust that OFPP will not unwittingly provide a public forum for a select group of large business concerns who wish to attack the "rule of two". Please respond to this request by November 2, 1984.

Because of the seriousness of this issue, we are forwarding a copy of this letter to Office of Management and Budget Director, David Stockman, to the Secretary of Defense, and to the Administrators of SBA, NASA and GSA, for such further action as may be deemed appropriate.

Sincerely,

Berkley Bedell
Berkley Bedell
Chairman, Subcommittee on
General Oversight and the
Economy

Parren J. Mitchell
Parren J. Mitchell
Chairman

PJM/BB/ttj

cc: Honorable David Stockman, Director
Office of Management and Budget

Honorable James C. Sanders, Administrator
Small Business Administration

Honorable Caspar W. Weinberger, Secretary
Department of Defense

Honorable Raymond Kline, Acting Administrator
General Services Administration

Honorable James M. Beggs, Director
National Aeronautic and Space Administration

defense and security or to the health and safety of the public.

The facility area has been inspected by NRC Region II inspectors and radiation surveys confirm that radiation levels meet the values acceptable to the Commission, and the area is available for unrestricted access.

OFPP Notice of Comment re FAR

Therefore, pursuant to the application filed by Tuskegee Institute, the licensee is hereby autorized to dispose of the component parts of the reactor, and Facility License No. R-122 is hereby terminated as of the date of this Order.

For further details with respect to this action see: (1) The application for authorization to dismantle facility and dispose of components parts and for termination of facility license, dated August 9, 1983, (2) the Commission's Safety Evaluation related to the termination of the license, and (3) the Notice of Proposed Issuance of Order Authorizing Disposition of Component Parts and termination of Facility License published in the Federal Register on June 12, 1984 at 49 FR 24180. Each of these items is available for public inspection at the Commission's Public Document Room, 1717 H Street, NW., Washington, D.C. Copies of items (2) and (3) may be obtained upon request addressed to the U.S. Nuclear Regulatory Commission, Washington, D.C. 20555, Attention: Director, Division of Licensing.

Dated at Bethesda, Maryland, this 2nd day of October 1984.

For the Nuclear Regulatory Commission.

Darrell G. Eisenhut,

Director, Division of Licensing.

[FR Doc. 84-[illegible] Filed 10-11-84; 8:45 am]

BILLING CODE 7590-01-M

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

Federal Acquisition Regulation (FAR) "Rule of Two"; Requirements for Setting Aside Acquisitions for Small Business

AGENCY: Office of Management and Budget.

ACTION: Notice of comment.

SUMMARY: The purpose of this notice is to solicit the views of all interested parties in both the public and private sector on the "rule of two" in Part 19 of the Federal Acquisition Regulation (FAR).

DATE: Comments are due on or before November 30, 1984.

FOR FURTHER INFORMATION CONTACT: William Maraist, Office of Federal Procurement Policy, OMB, (202-395-3300).

SUPPLEMENTARY INFORMATION: Although not new, the so called "rule of two" in FAR Part 19 has generated considerable controversy. The primary criticism is that this provision of the regulation did not receive adequate public notice and availability for comment.

The "rule of two" appears in FAR 19.502 which provides the requirements for setting aside acquisitions for small business:

"19.502 Setting aside acquisitions.

"19.502-1 Requirements for setting aside acquisitions.

Using the order of precedence in 19.504, the contracting officer shall set aside an individual acquisition or class of acquisitions when it is determined to be in the interest of (a) maintaining or mobilizing the Nation's full productive capacity, (b) war or national defense programs, or (c) assuring that a fair proportion of Government contracts is placed with small business concerns, and when the circumstances described in 19.502-2 or 19.502-3(a) exist.

"19.502-2 Total set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business—small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as a partial set-aside). Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

As shown above, the "rule of two" is part of the standard of competitiveness required before an acquisition may be set aside for small business—"a reasonable expectation that offers will be obtained from at least two responsible small business concerns * * * and awards will be made at reasonable prices." This standard was contained in the Defense Acquisition Regulation (DAR) and the NASA Procurement Regulation prior to the publication of the FAR. The Federal Procurement Regulations (FPR) coverage on set-asides, on the other hand, included a "sufficient number" standard. The FAR is essentially a consolidation of these two primary regulations. The drafters displayed the DAR and FPR coverages in side-by-side columns, and the proposed FAR coverage in a third column. These drafts were then made available for public comment. In the case of the set-aside provisions in question, the "sufficient number" standard was initially proposed for the FAR. Five of the six comments (including those of DOD, GSA, NASA and SBA) received on this provision requested that the language be amended to include the more specific criteria contained in the DAR (i.e., *two or more*) for determining if small business competition is available. The sixth comment requested added language to the effect that the set-aside would not impair agency mission or program requirements. Because contracting officers in the civil agencies had not consistently applied the "sufficient number" standard, and because the "rule of two" had worked well in DOD for more than five years as well as in NASA, the three regulatory agencies decided, in the final review phase, that the most workable standard for total set-asides was the "rule of two." "Sufficient number" as a standard provides little or no substantive guidance.

One of the issues raised by those who have criticized the "rule of two" is that in certain industries or product lines a disproportionate share of the Government's business is set-aside for exclusive participation by small businesses. However, this does not result from the "rule of two." The key to this issue is to the Small Business Act (15 U.S.C. 644) requirement that "* * * a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns * * *". Fair proportion is tied in the statute to *total* purchases and contracts made by the Government. The bulk of Federal expenditures are for major systems which, at the prime contract level, are unavailable to small business. Therefore, ensuring that small business receives a fair proportion of the *total* Government contracts practically dictates that a disproportionate share must be awarded to small business outside of the major systems area.

This is to be expected when there are *many* small businesses in a given industry sector. The experience of the major procuring agencies indicates that the result would not change, even if "sufficient number" or some other standard were substituted for the "rule of two." The agencies report substantial competition in the small business set-aside program with an average of ten or more competitors on each procurement. Therefore, the issue is not the method of determining whether there is adequate competition among small businesses. Rather, it appears to be whether the situation should be allowed to continue which results in such disproportionate shares of Federal requirements for particular products or services being set-aside for small business?

We believe that the FAR language complies with current law and reflects the will of the Congress as expressed in the Small Business Act. This method of implementing the fair proportion of *total* contracts has been upheld by the Courts and the Comptroller General.

Comments

All interested parties are invited to comment on the issue of the most appropriate standard for determining competitiveness in making a small business set-aside determination (e.g., rule of two, sufficient number, other standard). Comments should not be sent on the related issue of setting small business size standards. Small business size standards are set by the Small Business Administration and do not fall within the procurement policy authority of the Administrator for Federal Procurement Policy. Comments should be forwarded to William Maraist, Office of Federal Procurement Policy, OMB, 726 Jackson Place, Washington, DC 20503 on or before November 30, 1984. Mr. Maraist may be contacted by phone at 202-395-3300.

Dated: October 3, 1984.

Donald E. Sowle,

Administrator.

[FR Doc. 84-[illegible] Filed 10-11-84; 8:45 am]

BILLING CODE 3110-01-M

DEPARTMENT OF STATE

Office of the Secretary

Determination To Make Available Supplemental Military Assistance for El Salvador

Pursuant to the Second Supplemental Appropriations Act, 1984 (Pub. L. 98-396) and applicable delegations of authority, I hereby determine that the Government of El Salvador has demonstrated progress toward free elections, land reform, freedom of association, the establishment of the rule of law and an effective judicial system, and the termination of the activities of the so-called death squads, including vigorous action against members of such squads who are guilty of crimes and prosecution to the extent possible of such members who are past offenders.

This determination shall be transmitted to Congress immediately as part of the report required by Pub. L. 98-396 for the obligation and expenditure of supplemental military assistance funds for El Salvador after October 1, 1984.

This determination shall be published in the Federal Register.

George P. Shultz,

Secretary of State.

[FR Doc. 84-[illegible] Filed 10-11-84; 8:45 am]

BILLING CODE [illegible]

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

Proposed Advisory Circular 25.1455-XX; Waste Water/Potable Water Drain System Certification Testing

AGENCY: Federal Aviation Administration (FAA); DOT.

ACTION: Notice of Availability of Proposed Advisory Circular (AC) 25.1455-XX, and request for comments.

SUMMARY: This notice announces the availability of and requests comments on a proposed advisory circular (AC) concerning draining of fluids subject to freezing. This notice is necessary to give all interested persons an opportunity to present their views on the proposed AC.

DATES: Comments must be received on or before December 11, 1984.

ADDRESS: Send all comments on the proposed AC to: Federal Aviation Administration, Attention: Regulations and Policy Office, ANM-110, Northwest Mountain Region, 17900 Pacific Highway South, C-68966, Seattle, Washington 98168. Comments may be inspected at the above address between 7:30 a.m. and 4:00 p.m. weekdays, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Mark Quam, Regulations and Policy Office, at the address above, telephone (206) 431-2134.

SUPPLEMENTARY INFORMATION:

Comments Invited

A copy of the draft AC may be obtained by contacting the person named above under "FOR FURTHER INFORMATION CONTACT." Interested persons are invited to comment on the proposed AC by submitting such written data, views, or arguments as they may desire. Commenters should identify AC 25.1455-XX and submit comments, in duplicate, to the address specified above. All communications received on or before the closing date for comments will be considered by the Regulations and Policy Office before issuing the final AC.

Background

This AC sets *forth* a specific method of compliance with the requirements of § 25.1455 of the Federal Aviation Regulations (FAR). The method has been previously used and is designed to verify that, during flight, draining fluids will not accumulate as ice in sufficient quantity to be considered hazardous. Dyed fluid and painted surfaces are used. Freezing conditions are not required. The applicant may elect to follow an alternate test method, provided the alternate test method is also found by the FAA to be an acceptable means of complying with the requirements of § 25.1455.

Issued in Seattle, Washington, on October 1, 1984.

Leroy A. Keith,

Manager, Aircraft Certification Division, ANM-100.

[FR Doc. 84-[illegible] Filed 10-11-84; 8:45 am]

BILLING CODE 4910-13-M

Federal Highway Administration

Environmental Impact Statement; City of Charlottesville and Albemarle County, VA

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Notice of intent.

SUMMARY: The FHWA is issuing this notice to advise the public that an environmental impact statement will be prepared for a proposed highway project in the City of Charlottesville and Albemarle County, Virginia.

FOR FURTHER INFORMATION CONTACT: George E. Kirk, Jr., District Engineer, Federal Highway Administration, P.O. Box 10045, Richmond, Virginia 23240-0045, Telephone (804) 771-2380.

SUPPLEMENTARY INFORMATION: The FHWA, in cooperation with the Virginia Department of Highways and Transportation, will prepare an environmental impact statement (EIS) on a proposal to provide a four-lane divided facility from the intersection of existing McIntire Road and Preston Avenue to an intersection with existing Rio Road.

The proposed highway project involves in part the upgrading of an existing two-lane facility to a four-lane divided roadway. The remaining part of

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JUN 6 1984

MEMORANDUM TO JOE WRIGHT

FROM: DON SOWLE Don

SUBJECT: "Rule of Two" (Subject of your 3:00 PM meeting)

1. Attached is the exchange of correspondence on this subject with Jack Brooks.

2. "Rule of Two" is a red herring, not the real issue.

3. The real issue is the Small Business Set-Aside Program. The statute requires that a "fair proportion of total" Federal purchases go to small business. The set-aside program was designed to help achieve this objective. The problem arises in those industries (e.g., architect-engineers and construction) that have many competitive small businesses. In these cases, a majority of the procurements are set-aside for small business.

4. Achieving a fair proportion overall for small business means that a disproportionate share is awarded in some areas, such as A-Es and construction. This approach is supported by the major procuring agencies, the SBA, the GAO, and the Courts.

5. 99% of the A-E industry is classified as small business. A "rule of 50" would not change the set-aside picture. Therefore, the A-Es cannot point to the "rule of two" as the root of their problem. A meaningful fix would be to change the size standards.

Attachment

P.S. See "talking points" attached

TALKING POINTS

Vol. IV, No. 6, May 21, 1984

RECEIVED
84 JUN 6

CREATING A CLIMATE OF OPPORTUNITY

Small Business

"America's entrepreneurs and small business owners are among the most dynamic and innovative leaders of the business community. Their willingness to confront uncertainty with creativity and determination to succeed helps our Nation meet the challenges we face today. This spirit of accomplishment inspires Americans to look toward tomorrow with confidence and anticipation to the new opportunities open to future generations."

-- President Reagan
March 8, 1983

The importance of small business in America cannot be underestimated. There's no doubt about it -- small business means jobs. Nearly half the nation's workforce is employed by small businesses. The opportunity for entrepreneurs has never been brighter.

The Reagan Administration recognizes the importance of small business and during three years in office, it has worked to lessen impediments that hinder business growth and stifle imagination. As President Reagan said at the recent White House ceremony honoring the nation's outstanding small businessmen, "A big businessman is what a small businessman would be if only the government would get out of the way and leave him alone."

The administration's policies will benefit small business by:
- ensuring government promotes a strong, private economy;
- ensuring economic growth and full employment are restored and reduced; and
- ensuring that federal impediments to the free market are reduced or eliminated.

The Importance of Small Business

Small business, accounts for 42 percent of sales and 38 percent of our gross national product. Small business employs 47.8 percent of the private non-farm workforce. (The Small Business Administration [SBA] defines small businesses as those firms with less than 100 employees; 500 for manufacturing.)

- Of the 14.3 million non-farm businesses in the United States, approximately 99.7 percent, or more than nine of 10, of these businesses are small by SBA standards.

The Strength of Small Business

As evidence of a healthy, improving economy, small businesses have been enjoying substantial growth and success over the past three years.

- **JOBS:** Small business led the way in job-creation during the recovery. Between 1980 and 1982, small businesses generated all of the 984,999 net new jobs in the United States. Small business produced 2,650,000 new jobs, according to SBA, more than offsetting the 1,664,000 lost to larger businesses.

JUN 6 1984

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4. Achieving a fair proportion overall for small business means that a disproportionate share is awarded in some areas, such as A-Es and construction. This approach is supported by the major procuring agencies, the SBA, the GAO, and the Courts.

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Attachment

cc:
OFPP File/Chron/Reading
Mr. Maraist
Mr. Sowle

OFPP:WMaraist:mbd 6/6/84

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

May 30, 1984

Honorable Jack Brooks
Chairman
Committee on Government Operations
2157 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

This is in further response to your letter of March 14, 1984 concerning the "rule of two or more" contained in the Federal Acquisition Regulation (FAR 19.502-2).

Mr. Stockman's interim response of April 4, 1984 indicated that we had requested additional information from the three regulatory agencies, DOD, GSA, and NASA. Having received their responses and coordinated with the Small Business Administration, we are able to provide information on the points in your March 14 letter: 1) that FAR 19.502-2 is in violation of law, 2) your request for an explanation of how FAR 19.502-2 came to be included in the regulation and at whose request, and 3) your recommendation that action be taken to remove these provisions from the FAR.

1) Your letter states that small business total set-aside provisions are in violation of current law. Your letter states that, "It is inherently unfair to turn over the Federal marketplace to any single economic group," indicates that your concern is with those situations where virtually all of the Government's requirements for certain products or services are set-aside for small business. We understand this concern but its cause does not lie with the "rule of two or more." The application of the "rule of two or more" or the "sufficient number" standard for determining the extent of small business competition would not normally change the situation where all Federal requirements in a particular industry sector are set-aside for small business. These situations occur when there are many small businesses in an industry sector and the decision to set aside would most often be the same using either standard. The agencies have reported substantial competition in the small business set-aside program with an average of ten or more competitors on each procurement. Therefore, the issue is not the method of determining the existence of adequate competition among small businesses, but rather, should the situation be allowed to continue which results in all Federal requirements for particular products or services being set-aside for small business?

The Small Business Act (15 USC 644) has long been held to authorize the use of set-aside procurement method for any contract (or part of a contract) whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns...." (Underlining added.) The rule of two or more only comes into play after any of the foregoing four considerations have been satisfied and the FAR merely continues that policy.

The key to this issue is that "fair proportion" is tied to total purchases and contracts made by the Government. Since the bulk of Federal expenditures are for major systems which, at the prime contract level, are unavailable to small business, implementation of the Small Business Act requirement that a fair proportion of the total Government contracts be placed with small business practically dictates that disproportionate shares must be awarded outside of the major systems area. We believe the FAR language complies with current law and reflects the will of the Congress as expressed in the Small Business Act. This method of implementing the fair proportion of total contracts has been upheld by the Courts.

2) In response to the second point raised in your letter, we note that this change was a result of the established FAR drafting, public comment, and review procedures. In this case, the FPR and the DAR contained different provisions. The FPR version, which contained the "sufficient number" standard, was initially published for comment. Five of the six comments (including those of DOD, GSA, NASA and SBA) received on this provision requested that the language be amended to include the more specific criteria for determining if small business competition is available (i.e., "rule of two or more"). The sixth comment requested added language to the effect that the set-aside would not impair agency mission or program requirements. Because of prior inconsistent application by contracting officers in the civil agencies of the "sufficient number" standard, and because the rule of two or more has worked well in DOD for more than five years as well as in NASA, the three regulatory agencies decided, in the executive review phase, that the most workable standard for total set-aside in implementing the Small Business Act was the rule of two. Responses from DOD, GSA and NASA confirmed this view.

3) We totally concur that the major purpose of procurement is to serve agency missions in a cost-effective manner. However, there are curently a large number of non-procurement related public policies (socio-economic goals) implemented through the Federal procurement process. Although the procurement community consistently points out the burden imposed by these policies, we recognize that a balance must be struck between pure business management efficiencies and fairness in contracting and the attainment of these public policies established by law. Under Section 7 of P.L. 98-191, "Tests of Innovative Procurement Methods and Procedures," we have begun to work with the agencies to identify potential areas for study. These issues could surface as potential candidates for study.

Both the FPR and DAR provisions on total set-aside were considered to be reasonable implementations of the Small Business Act and have been supported by the Comptroller General. The FAR ultimately settled on the "rule of two or more" vs. "sufficient number" criteria which is consistent with the Small Business Act and which requires a fair proportion of total Federal procurement be awarded to small business. I hope this information will be useful. If I can be of further assistance, please let me know.

Sincerely,

Don Sowle

Donald E. Sowle
Administrator

84/03/16

OFFICE OF MANAGEMENT AND BUDGET
CORRESPONDENCE CONTROL

RECEIVED OFPP

84 MAR 19 A10 : 10

OMB CONTROL NO: 17909
CORRESPONDENT : CHAIRMAN JACK BROOKS
ORGANIZATION : RPTX
DATE OF CORR. : 84/03/14

FOR ACTION : OFPP

INFO : AD/LA
OTHER REF :

COMMENTS :

INSTRUCTIONS: PREPARE REPLY FOR LEGISLATIVE AFFAIRS SIGNATURE
CARBON COPY TO OMB LEGISLATIVE AFFAIRS OFFICE

RESPONSE DUE TO LEGISLATIVE AFFAIRS OFFICE
BY 84/03/26

SUBJECT: FAR FEDERAL PROCUREMENT

REMARKS:

	PREPARED	CLEARED	CLEARED	CLEARED	CLEARED	CLEARED
SURNAME AND DIVISION						
INITIALS AND DATE						

NINETY-EIGHTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, D.C. 20515

MAR 16 9

ACE UNIT

March 14, 1984

The Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Dave:

It has come to my attention that the Federal Acquisition Regulation (FAR), which is to become effective on April 1, 1984, contains provisions which require that all Federal procurements be set aside exclusively for small business participation if there are two small business concerns available to meet the government's requirements. These provisions violate current law and create a serious restriction on the government's ability to obtain goods and services from the maximum practicable number of vendors at the lowest cost.

While I support efforts to open up the Federal marketplace to small business, I strongly oppose these provisions. It is inherently unfair to turn over the Federal marketplace to any single economic group. The major purpose of procurement is to serve agency missions in a cost-effective manner. If we sacrifice this principle in order to achieve other goals, it will not only substantially increase costs, but may do untold harm to agency missions.

It is my understanding that the "rule of two" set aside provisions were not included in the version of the FAR that went out for public comment. I would appreciate an explanation of how they came to be included in the regulation and at whose request. In any case, I recommend that you take action to remove these provisions before they become effective on April 1.

With best wishes, I am

Sincerely,

JACK BROOKS
Chairman

FAR 19.502-2

.079

APR 5 1984

MEMORANDUM TO: MARY ANN GILLEECE, DOD
ALLAN BERES, GSA
STU EVANS, NASA

FROM: DAVID A. STOCKMAN D. A. S.

SUBJECT: Response to Congressman Brooks

The attached letter from Congressman Brooks raises questions regarding the "rule of two" small business set-aside provisions in FAR 19.502-2. Please provide information on which to base a response to Mr. Brooks.

It is our view that, while the receipt of responsive offers from two responsible offerors has long been acceptable as evidence of adequate price competition for purposes of complying with P.L. 87-653, it is quite another matter to adopt a standard which limits the competitive field based on the presumption or possibility of competition but which in fact may not ensure either competition or reasonable prices. This appears to have been caused by confusion over the distinction between "competition" as an end result and "competitive procedures."

We would appreciate your response, including your position on changing FAR 19.502-2, by April 13, 1984.

cc:
OFPP Official File
DO Chron
DO Records
Legislative Affairs
Correspondence Unit
OFPP Chron/Reading
Mr. Maraist

OFPP:WMaraist:mbd 3/28/84 OMB Control #: 17909

APR 5 1984

Honorable Jack Brooks
Chairman
Committee on Government Operations
2157 Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

This is an interim response to your letter of March 14, 1984 concerning the "rule of two" contained in the Federal Acquisition Regulation (FAR 19.502-2).

The receipt of responsive offers from two responsible offerors has long been acceptable as evidence of adequate price competition for purposes of complying with The Truth in Negotiation Act, P.L. 87-653. However, the "rule of two" limits the competitive field based on the presumption or possibility of competition but in fact may not ensure either competition or reasonable prices. There appears to be some confusion over the distinction between "competition" as an end result and "competitive procedures."

We have requested that the procurement regulatory agencies, Department of Defense, General Services Administration, and the National Aeronautics and Space Administration provide additional information to us, after which we will be able to give you a more complete response. A copy of our request to these agencies is enclosed.

Sincerely,
David A. Stockman

David A. Stockman
Director

Enclosure

cc:
✓ OFPP Official File
DO Chron
DO Records
Legislative Affairs
Correspondence Unit
OFPP Chron/Reading
Mr. Maraist

OFPP:WMaraist:mbd 3/28/84 OMB Control #: 17909
OFPP::mbd 4/3/84

4/3-DD

OFFICE OF MANAGEMENT AND BUDGET
ABSTRACT OF CORRESPONDENCE

TO: David Stockman

FROM: Donald E. Sowle, OFPP

OUTGOING TO: Congressman Jack Brooks and Memo to DOD, GSA, & NASA

SUBJECT: Small Business Set-Aside Provision in FAR

1. This is an interim response to Mr. Brooks pending receipt of information from DOD, GSA & NASA.
2. The issue involves the determination to set-aside a procurement exclusively for small business if "at least two" small businesses will compete.
3. Before a complete response to Mr. Brooks is possible we should know what considerations led the regulatory agencies to the current FAR language.
4. The receipt of responsive offers from two responsible offerors is accepted as adequate price competition for purposes of complying with the Truth-in-Negotiation Act. However, the "rule of two" limits the competitive field based on a possibility of competition, but in fact may not ensure either competition or reasonable prices.

Joe-
After conversation w/ Don Sowle; I conclude:
- We should ignore Brooks' mention of the 4/1 implementation date for the FAR
- we don't need to explicitly state that we agree with him at this point
- we should give DOD GSA and NASA an opportunity to defend the provision.

OK

CONTROL NO. 17909
3069-3

	PREPARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY
JRNAME AND DIVISION (Typed)	Maraist OFPP	Sowle OFPP	DeMuth OIRA	Upton LA	Gerson DO	Wright DO	Ed Dale
ITIALS AND TE	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]		

84/03/16

OFFICE OF MANAGEMENT AND BUDGET
CORRESPONDENCE CONTROL

RECEIVED OFPP
84 MAR 19 A10 : 10

→ Bud
amg 3-21-
1:30pm

OMB CONTROL NO: 17909
CORRESPONDENT : CHAIRMAN JACK BROOKS
ORGANIZATION : RPTX
DATE OF CORR. : 84/03/14

FOR ACTION : OFPP

INFO : AD/LA
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RESPONSE DUE TO LEGISLATIVE AFFAIRS OFFICE
BY 84/03/26

SUBJECT: FAR FEDERAL PROCUREMENT

REMARKS:

	PREPARED	CLEARED	CLEARED	CLEARED	CLEARED	CLEARED
SURNAME AND DIVISION						
INITIALS AND DATE						

A

NINETY-EIGHTH CONGRESS
Congress of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 Rayburn House Office Building
Washington, D.C. 20515

MAR 16 9
PLACE UNIT

March 14, 1984

The Honorable David A. Stockman
Director
Office of Management and Budget
Washington, D.C. 20503

Dear Dave:

It has come to my attention that the Federal Acquisition Regulation (FAR), which is to become effective on April 1, 1984, contains provisions which require that all Federal procurements be set aside exclusively for small business participation if there are two small business concerns available to meet the government's requirements. These provisions violate current law and create a serious restriction on the government's ability to obtain goods and services from the maximum practicable number of vendors at the lowest cost.

While I support efforts to open up the Federal marketplace to small business, I strongly oppose these provisions. It is inherently unfair to turn over the Federal marketplace to any single economic group. The major purpose of procurement is to serve agency missions in a cost-effective manner. If we sacrifice this principle in order to achieve other goals, it will not only substantially increase costs, but may do untold harm to agency missions.

It is my understanding that the "rule of two" set aside provisions were not included in the version of the FAR that went out for public comment. I would appreciate an explanation of how they came to be included in the regulation and at whose request. In any case, I recommend that you take action to remove these provisions before they become effective on April 1.

With best wishes, I am

Sincerely,

Jack Brooks

JACK BROOKS
Chairman

FAR 19,502-2

1909

HANDLING

☐ Urgent! (Hand-carry) ☐ Expedite (Time sensitive) ☒ Regular Handling

☐ Decision Memo ☐ Information Memo Control # ________

☐ Correspondence Outgoing to Federal Register & Heads of Executive Depart nts & Establishments

SPECIAL HANDLING INSTRUCTIONS

SHORT SUMMARY OF MATERIAL

The OFPP, on October 12, 1984, requested comments in the Federal Register on the most appropriate standard for determining competitiveness in making small business set-aside determinations. Over 200 comments were received. Also, Congressional interest was shown both for and against current provisions in FAR 15.502-2.

After consideration of all comments and other factors involved, OFPP has determined that Policy Letter 86-1, attached, represents the best solution to a very different problem. Policy Letter 86-1 modifies FAR 15.502-2 and cautions contracting officers not to apply set-aside provisions too automatically, especially in view of recent changes effected by the Competition in Contracting Act.

					LR	Johnson ADMIN	
	PREPARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY
NAME AND DIVISION	Birnbaum OFPP	Mathis OFPP	Gramm OIRA	Mathiasen BRD	Carley GC	Dineen AD/M	Wright DO
INITIALS AND DATE							

Mr. James Graves
Office of the Federal Register
National Archives and Records Service
Washington, DC 20408

Dear Mr. Graves:

Enclosed for publication in the Federal Register is Policy Letter 86-1, "Total Small Business Set-Aside Determinations."

Please inform us of the Federal Register issue containing the notice.

Sincerely,

Darrell A. Johnson
Deputy Associate Director
for Administration

Enclosure

cc:
Official File
DO Chron
DO Records
Deputy Director
General Counsel
Mr. Johnson
Mr. Maraist
Mr. Mathis
OFPP Chron/Reading
OFPP:OBirnbaum:mbd 12/30/85

OFFICE OF MANAGEMENT AND BUDGET
OFFICE OF FEDERAL PROCUREMENT POLICY

OFPP Policy Letter 86-1, Total Small Business
Set-Aside Determinations

AGENCY: Office of Management and Budget, Office of Federal Procurement Policy (OFPP).

ACTION: Final Policy Letter.

SUMMARY: This Policy Letter modifies policy as to the most appropriate standard for determining competitiveness in making a small business total set-aside determination.

DATE: This Policy Letter will be effective when implemented in the Federal Acquisition Regulation, Part 19. Under the provision of the OFPP Act and OFPP Policy Letter 85-1 implementation in the FAR by April 30, 1986, shall be considered timely.

FOR FURTHER INFORMATION CONTACT: William J. Maraist, Office of Federal Procurement Policy, OMB, 726 Jackson Place, N.W., Washington, DC 20503, (202-395-3300).

SUPPLEMENTARY INFORMATION: On October 12, 1984, OFPP solicited public comment (49 F.R. 199, p. 40135) on the issue of the most appropriate standard for determining competitiveness in making a small business total set-aside determination. Approximately sixty percent of those commenting opposed the provision as stated in Part 19 of the Federal Acquisition Regulations; forty percent were in favor. Almost all the comments in favor of the provision came from small businesses; the responses opposing the provision came, generally, from architect-engineering and other professional organizations.

Subsequent to the passage of the Competition and Contracting Act of 1984 (CICA), the Chairman of the House Government Operations Committee, along with other members of the House and Senate, make known to OFPP his views that the small business total set-aside provisions of the FAR were inconsistent with CICA, particularly Section 2733. It has also been urged that these provisions unduly restrict competition, especially in the light of the requirement in Section 2733 that the Government's requirements be "fulfilled at the lowest reasonable cost."

All comments received and Congressional expressions of interest were carefully considered in drafting the following Policy Letter.

William E. Mathis
Acting Administrator

Dated: ____________________

OFPP POLICY LETTER 86-1

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Total Small Business Set-Aside Determinations

1. PURPOSE. The purpose of this Policy Letter is to assure uniform and appropriate implementation of the Competition in Contracting Act of 1984 (CICA) with respect to total small business set-aside determinations.

2. AUTHORITY. This Policy Letter is issued pursuant to Section 6 of the Office of Federal Procurement Act, 41 U.S.C. 405.

3. BACKGROUND. As a result of public reaction to the final small business total set-aside provisions of the Federal Acquisition Regulation (FAR) paragraph 19.502-2 the Office of Federal Procurement Policy, on October 12, 1984, solicited public comment on the issue of the most appropriate standard for determining competitiveness in making a small business total set-aside determination. The FAR provision states:

> "The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as to partial set asides)."

Approximately sixty percent of those commenting opposed the provision; forty percent were in favor. Almost all the comments in favor of the provision came from small businesses; the responses against the proposal came, generally, from architect-engineering and other professional organizations.

Section 2733 of the Competition in Contracting Act of 1984 (CICA) amends section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured."

Further, the Conference report on this section states that the:

> "Conference substitute amends Section 16(1) of the OFPP Act to require the use of full and open competition in Executive agency procurements of property and services .... language contained in this substitute requires agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under the set-aside programs."

Subsequent to the passage of CICA, the Chairman of the House Government Operations Committee, along with other members of the House and Senate, made known to OFPP his views that the small business total set-aside provisions of the FAR were inconsistent with CICA. It has also been urged that these provisions unduly restrict competition, especially in the light of the new OFPP Act requirement that the Government's requirements be "fulfilled at the lowest reasonable cost."

4. POLICY. (a) In making small business total set-aside determinations, contracting officers shall be made aware of the terms of 41 USC 414 which provide that "the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices increase the use of full and open competition in the procurement of property and services by the executive agency establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive

proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured."

(b) Contracting officers shall be made aware, therefore, that when making small business total set-aside determinations there may be instances where the receipt and consideration of an absolute minimum of two offers may not be adequate, especially where one of the sources is marginally responsible. In such instances an unrestricted procurement would be more appropriate and better serve the interests of the Government.

5. EFFECTIVE DATE. This Policy Letter will be effective when implemented in FAR Part 19. Under provisions of the OFPP Act and OFPP Policy Letter 85-1 implementation in the FAR by April 30, 1986 shall be considered timely.

6. CONCURRENCE. This Policy Letter has the concurrence of the Director of the Office of Management and Budget.

William E. Mathis
Acting Administrator

cc:
OFPP Official File
DO Chron
DO Records
General Counsel
B&MO Records
OFPP Chron/Reading
Mr. Birnbaum
Mr. Mathis

OFPP:OBirnbaum:mbd 12/27/85

OFFICE OF MANAGEMENT AND BUDGET
OFFICE OF FEDERAL PROCUREMENT POLICY

48 CFR Chapter 1, Parts 6 and 19

Notice to DOD, GSA, and NASA Regarding Federal Acquisition Regulation on Small Business Set-Aside Determinations

AGENCY: Office of Management and Budget - Office of Federal Procurement Policy (OFPP).

ACTION: Notice under provisions of OFPP Policy Letter 85-1, paragraph 7.

SUMMARY: The Acting Administrator of OFPP has issued the notice set forth below to DOD, GSA, and NASA under the provisions of paragraph 7 of OFPP Policy Letter 85-1 and 41 USC 405. The required regulatory change is necessary to implement 41 USC 414(l) with respect to small business set-aside determinations.

FOR FURTHER INFORMATION CONTACT: William Maraist, Office of Federal Procurement Policy, OMB (202-395-3300).

SUPPLEMENTARY INFORMATION: The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses..." if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices."

However, in July, 1984, Section 2733 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1934. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost" as a standard of competition for all procurements "including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's reqirements at the lowest reasonable cost. Therefore, the following letter to DOD, GSA, and NASA provides notice that the FAR must be changed to properly implement the Competition in Contracting Act (41 USC 414) by explicitly stating this standard.

MEMORANDUM TO: SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

Further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter 85-1 that the FAR must be amended in a timely manner to implement Section 2733 of CICA. Regulatory change substantially as follows will be considered timely under OFPP Policy Letter 85-1 if implemented on or before ________________, 1986:

PART 6 -- COMPETITION REQUIREMENTS

Subpart 6.1 -- Full and Open Competition

1. Section 6.101 Section 6.101 Policy is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 -- SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 -- Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved, will apply to each subsequent procurement in that class.

SECTION 19.502 -- SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Honorable John Heinz
United States Senate
Washington, DC 20510

Dear John:

This is in reply to your letter of April 2, 1985, on the Total Set-Asides Provision (TSAP) or "Rule of At Least Two" contained in the Federal Acquisition Regulation (FAR) 19.502-2, implementing the Small Business Act.

As you note, the TSAP provides that an acquisition shall be set aside for exclusive small business participation if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable prices."

There is no statutory basis for the "Rule of At Least Two." It was first adopted by the Department of Navy in 1964, by the Department of Defense in 1979, as a replacement for the earlier "sufficient number" test. It was instituted because (1) the term "sufficient number" was believed to be imprecise and subject to varying interpretations by contracting officers; and (2) contracting officers unsympathetic to the small business program reportedly used the "sufficient number" test to avoid making small business set-asides.

The "rule" does not mean that a contracting officer need only solicit two small business sources, regardless of the number of small business sources available. It does mean that identification by a contracting officer of two or more such firms whose competition will lead to a reasonable price is sufficient to initiate a set-aside.

The FAR version that went out for public comment in September 1983 included the "sufficient number" standard then still used by the civilian agencies. At the request of five of the six comments received on this provision, the final FAR, effective April 1, 1984, adopted the "Rule of At Least Two" standard.

Congressman Jack Brooks wrote me on March 14, 1984 to question the FAR use of the "Rule of At Least Two." His letter is attached.

Subsequently, in the Competition in Contracting Act (CICA), Pub. L. 98-369 (signed into law on July 18, 1984), Congress amended Section 16 of the Office of Federal Procurement Policy Act (OFPPA) to require executive agencies to

> "increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures and practices that assure that the executive agency receives *a sufficient number* of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the *lowest reasonable cost* considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers in the Conference Report states:

> "This requirement applies to all agency procurements, *including those made under set-aside programs*." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1934. (Emphasis added.)

Although there is no explicit reference in CICA or its legislative history to replacing the "Rule of At Least Two," the attached joint December 12, 1984 letter from Senators Cohen and Levin and Congressmen Brooks and Horton asserted that the FAR "Rule of At Least Two" provision "runs contrary to" Section 16 of the OFPPA. Others, however, regard this conclusion as erroneous, noting that the CICA section concerns the necessity of *receiving* a sufficient number of proposals to insure the lowest reasonable cost while the "rule" involves criteria upon which a contracting officer *institutes* a set-aside.

On October 12, 1984, OFPP solicited public comment on the rule in Part 19 of the FAR, on the grounds that it had "generated considerable controversy" and had been criticized for not receiving "adequate public notice and availability for comment." 49 Fed. Reg. 40135 (October 12, 1984).

OFPP is presently completing its analysis both of the comments it has received in response to the Federal Register notice and of the comments made in the December 12 joint Congressional letter, and will provide this analysis to the FAR councils, which are currently preparing FAR revisions to implement CICA.

I trust this information is helpful to you. Please feel free to have your staff call Owen Birnbaum at 395-3254 for any additional information.

Sincerely,

David A. Stockman
Director

Enclosures

Honorable John Heinz
United States Senate
Washington, D.C. 20510

Dear John:

This is in reply to your letter of April 2, 1985, on the Total Set-Asides Provision (TSAP) or "rule of two" contained in the Federal Acquisition Regulation (FAR) 19.502-2, implementing the Small Business Act.

As you note, the TSAP provides that an acquisition shall be set aside for exclusive small business participation if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable prices."

There is no statutory basis for the "rule of two." It was first adopted by the Department of Navy in 1964, by the Department of Defense in 1979, as a replacement for the earlier "sufficient number" test. It was instituted because: (1) the term "sufficient number" was believed to be imprecise and subject to varying interpretations by contracting officers; and (2) contracting officers unsympathetic to the small business program purportedly used the "sufficient number" test to avoid making small business set-asides.

The FAR version that went out for public comment in September, 1983 included the "sufficient number" standard then still used by the civilian agencies. At the request of five of the six comments received on this provision, the final FAR, effective April 1, 1984, adopted the "rule of two" standard.

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> "increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures and practices that assure that the executive agency receives

> *a sufficient number* of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the *lowest reasonable cost* considering the nature of the property or service procured." (Emphasis added.)

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> "This requirement applies to all agency procurements, *including those made under set-aside programs.*" H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1934. (Emphasis added.)

Insrt A

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Sincerely,

David A. Stockman
Director

cc: Official File-EO Records
DO Records
DO Chron
Deputy Director
General Counsel
OGC Chron
Mr. Birnbaum
Mrs. Weinstein
DO:OGC:DGWeinstein:vs:4-30-85

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND
LOGISTICS

[illegible]

Honorable Jack Brooks, Chairman
House Committee on
  Government Operations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

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Representatives of both Councils are available to meet with members of your staff should you desire further discussions. An identical letter is being sent to Congressman Horton. A similar letter is being sent to Senators Cohen and Levin.

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DEPARTMENT OF DEFENSE	GENERAL SERVICES ADMINISTRATION	NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ELEANOR R. SPECTOR	ALLAN W. BERES	S. J. EVANS
Deputy Assistant Secretary of Defense for Procurement	Assistant Administrator for Acquisition Policy	Assistant Administrator for Procurement

Attachments
# 1-Responses to 12 Dec 84 letter
2-Responses to 19 Jul 85 letter

cc: GAO

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON D C 20301-8000

ACQUISITION AND
LOGISTICS

DASD(P)/DARS

Honorable Frank Horton
Ranking Minority Member
House Committee on
  Government Operations
House of Representatives
Washington, D.C. 20515

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RESPONSE: Concur in part. In order to clarify that only unsolicited research proposals may be processed to a non-competitive award using the traditional procedures of FAR 15.5 (and previously in DAR 4-900) in accordance with P.L. 98-369, the coverage will be modified to more specifically address unsolicited research proposals. The coverage currently in FAR Subpart 15.5 complies with P.L. 98-369 and, in addition, recognizes that there are non-research "unsolicited" proposals that are submitted (as well as unsolicited research proposals not meeting the criteria in P.L. 98-369 and FAR 15.503(c)) and provides guidance to contracting officers on the requirements for handling these actions (at FAR 15.507) that essentially directs them to comply with FAR Parts 5 and 6. This coverage will, however, be modified to clarify that unsolicited proposals other than valid unsolicited research proposals may not be processed under the abbreviated procedure authorized by P.L. 98-369 as implemented at FAR 6.302-1(b)(3). Since the term "unique" is not given any special meaning in the law or regulation different than its normally understood definition, additional guidance concerning this term is not deemed necessary or appropriate.

14. (FAR 19.502-2). FAR 19.502-2 retains the "Rule of Two" provision, which we believe is no longer appropriate under CICA. The minimal standard for competition established by the "Rule of Two" provision runs contrary to section 16 of the Office of Federal Procurement Policy Act, as amended by CICA, which requires agencies "to increase the use of full and open competition...by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or proposals from responsive sources..." The Conference Report clearly states on page 1434 that this requirement applies to "all agency procurements, including those made under set-aside programs."

RESPONSE: We do not interpret the "Rule of Two" to be in conflict with CICA. Use of the rule contemplates full and open competition after a set aside decision has been made.

15. (FAR 4.6). The FAR does not incorporate the record requirements in CICA, which amend section 19 of the Office of Federal Procurement Policy Act. These provisions are required to be implemented on a government-wide basis.

RESPONSE: For the Department of Defense, DD Form 350, for NASA, Form 507, and for the civilian agencies, Standard Form 279 were all revised to comply with Section 19 of CICA. Information required by CICA is being collected by each executive agency on these forms and entered in the Federal Procurement Data System on a Government-wide basis.

14
12/24/85

OFFICE OF MANAGEMENT AND BUDGET
CORRESPONDENCE CONTROL

----- HANDLING ----------

------ URGENT (HAND-CARRY)
------ EXPEDITE (TIME SENSITIVE)
--X--- REGULAR HANDLING

OMB CONTROL NO: 22058
CORRESPONDENT: CHAIRMAN JACK BROOKS OF: GOV OPS CMTE

SUBJECT: PROCUREMENT FAR

LEAD TO: OFPP INFO COPIES: AD/LA
X REFERENCE: HORTON

----- SHORT SUMMARY OF MATERIAL ----------

----- HANDLING INSTRUCTIONS ----------

RESPONSE DUE BY 01/03/86.
FOR SIGNATURE OF DEPUTY DIRECTOR BY 01/08/86.

	PREPARED	CLEARED	CLEARED	CLEARED	CLEARED	CLEARED	CLEARED	CLEARE
NAME AND DIVISION								
INITIALS AND ----								

12/24/85

OFFICE OF MANAGEMENT AND BUDGET
CORRESPONDENCE CONTROL

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INITIALS AND DATE								

OFFICE OF MANAGEMENT AND BUDGET

HANDLING

☐ Urgent! (Hand-carry)   ☐ Expedite (Time sensitive)   ☒ Regular Handling

☐ Decision Memo   ☐ Information Memo   ☐ Testimony/Speech

☒ Correspondence, Outgoing to Secretary of Defense
Administrator, NASA
Administrator of General Services

Control # ____________

SPECIAL HANDLING INSTRUCTIONS

TC Bill Clemen
2/6 5:10

SHORT SUMMARY OF MATERIAL

We understand from the General Counsel's staff that you have concluded that the "rule of two" should be cancelled and that you have directed that we take the necessary action, under authorities provided by the OFPP Act, to do so. I share the reservations that Bill Mathis discussed with you on several prior occasions regarding cancellation of the rule; reservations that are shared by many in the Federal procurement community. But, recognizing this as a legitimate policy option for the Administration to pursue, I have prepared a notice to the heads of the three procurement regulatory agencies directing them to modify the pertinent parts of the Federal Acquisition Regulation, replacing the "rule of two" with the "sufficient number" standard.

This notice is attached for your approval - and reflects the procedures established in OFPP Policy Letter 85-1, negotiated with the agencies and approved by the Director last August, which lays down the steps to activate the statutory authority for OFPP involvement in the FAR regulatory process. This notice gives the agencies 60 days to change the FAR including the requirement for public comment.

	PREPARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY
NAME AND DIVISION	Baker OFPP	Dineen AD/M	Gramm OIRA	Carley GC	Wright DO		
INITIALS AND DATE	Baker 2/5/86						

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MEMORANDUM TO: ✓SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses "...if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices."

However, in July 1984, Section 2733 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1934. (Emphasis added.)

a decision [illegible] ~~[illegible]~~ within 30 days of ~~[illegible]~~ the following proposed regulation [illegible] this lette

2 [illegible]

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. Therefore, further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter ~~85-1 that the FAR must be amended in a timely manner to implement Section 2733 of CICA. Regulatory change substantially as follows (and concurred in by the Director, OMB) will be considered timely under OFPP Policy Letter 85-1~~ only if ~~if implemented within 60 days of the date of this letter. Public comment should be obtained within this period.~~

for 30 days comm

~~by publication of~~

PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

following

~~the regulation is published within 30 days~~

30 days for comment

~~use proposed rule~~

PART 19 — SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 — Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 — SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

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cc: GAO

Responses to 12 December 1984 Letter

1. ((FAR 6.302-1(b)). FAR 6.302-1(b) cites examples in which the first exception to the requirement for full and open competition may be used. Under the first example (FAR 6.302-1(b)(1)), however, the condition for going sole-source -- "the required supplies or services are available from only one source" -- is clearly less restrictive than the statutory exception, which requires as a further condition that no other type of property or services will satisfy the agency's needs.

RESPONSE: FAR 6.302-1(a) contains the statutory citations and language required by Public Law 98-369. Said language includes the condition "...and no other type of supplies or services will satisfy agency requirements." FAR 6.301(b) requires the contracting officer to insert the specific statutory authority (U.S. Code citation) applicable. It is this test that the contracting officer must satisfy before commencing negotiations without having provided for full and open competition.

2. (FAR 6.302-1(b)(2)&(3)). The treatment of follow-on contracts and unsolicited proposals --listed as the second and third examples, respectively, under the first exception -- is equally troubling. As currently written, these examples do not limit the sole-source award in either case to the conditions specified in CICA. Since the proposed regulations state that the list of examples is "not intended to be all inclusive," a contracting office may attempt to justify a sole-source award of follow-on contracts or unsolicited proposals unrelated to the specified conditions, which is not authorized under CICA.

RESPONSE: Concur. The coverage will be clarified to ensure that unsolicited research proposals and follow-on contracts must comply with the conditions specified in the statute. The language will be modified to further clarify the specific authority available under 6.302-1 (including all statutory parameters associated therewith).

3. (FAR 6.302-1(b) and 6.303-1(c)). The remainder of examples under the first exception seek to create broad categories for sole-source award which are not authorized under CICA. Determinations and decisions required to use this exception are to be made on a case-by-case basis pursuant to the criteria provided. See related problem with FAR 6.303-1(c).

RESPONSE: 6.302-1(b): The examples are not provided to broaden the statute but rather to make more clear the limitations of the statute and to be helpful to the contracting officer. The examples are not authorities in and of themselves, but are merely situations in which the authority of 6.302-1(a) may be used.

ATTACHMENT #1

6.303-1(c): We concur that the wording under this subpart may lead one to conclude that a contracting officer does not need to review each contracting action on a case-by-case basis. Therefore, we will change this subpart to require the contracting officer to ensure, on a case-by-case basis, that each contract action taken pursuant to the authority of a Class Justification and Approval is within the scope of the J&A and the contracting officer shall document the contract file accordingly.

4. (FAR 6.302-1(b)(2)). The FAR provisions do not reflect our intent, as expressed on page 1426 of the Conference Report, that noncompetitive follow-on contracts are to be limited to those awarded after (1) an original competitive award and (2) a cost-benefit analysis is conducted to determine and document whether the initial capital investment could cause substantial duplication of cost if the contract were awarded to other than the original source, or whether such cost could be offset by savings resulting from competition.

RESPONSE: Provided that all elements of the law are met ("...award to a source other than the original source would result in (i) substantial duplication of cost to the United States which is not expected to be recovered through competition, or (ii) unacceptable delays in fulfilling the agency's needs,..."), the contracting circumstances of the original award should not be the determinative factor. The history of an acquisition, i.e., whether the original award was competitive or non-competitive, cannot be changed (although all original awards resulting from solicitations issued on or after 1 April 1985 must comply with P.L. 98-369.) To limit follow-on acquisitions to only those which occur after a competitive original award does not give recognition to the objective contracting situation at the time of the follow-on procurement and could prove damaging to fulfillment of the agency's mission, including increased cost and unacceptable delays. FAR 6.303-2(a)(9)(ii) further addresses the documentation requirements for follow-on contracts.

5. (FAR 6.302-1(c)(2)). FAR 6.302-1(c)(2) provides that for contracts awarded under the first exception, the notices required by FAR 5.201 "shall have been published and any bids or proposals must have been considered." The FAR, does not, however, provide additional guidance regarding what constitutes "consideration." The Conference Report states on page 1427 that "agencies should at a minimum, give each bid or proposal...sufficient consideration so as to be able to make an informed judgment about the responsibility of the bidder and the responsiveness of the bid."

RESPONSE: Formal bids or proposals are generally not solicited by public notices (synopses) but by subsequent solicitations. This is to assure that all prospective offerors are equally aware of all of the Government's requirements (the basis for award, etc.) which cannot all be addressed in the synopsis. As currently stated in Note 22 of the Commerce Business Daily (required by FAR 5.207(d)(3) to be cited in synopses announcing an intended sole source award), information received as a result of the notice (synopsis) will be considered for the purpose of determining whether to conduct a competitive procurement.

FAR 15.402(g) further requires that, if the contracting officer determines, after consideration of responses to a synopsis citing the authority of FAR 6.302-1, that more than one source can meet the Government's needs, the contracting officer shall then issue a competitive solicitation and shall comply with FAR Part 5 synopsis requirements (i.e., a new synopsis would normally be published). The determinative process required by FAR 15.402(g) would involve consideration of the overall potential of a prospective offeror to meet the Government's needs, as expressed in the information submitted by prospective offerors in response to this type of synopsis. Formal determinations of responsiveness and responsibility are made based upon proposals or bids submitted in response to formal solicitations.

6. (FAR 6.303). Under CICA, an executive agency may not "procure property or services from another executive agency unless such other executive agency complies fully with the requirements of this title." This provision is included, according to page 1428 of the Conference Report, "to prevent one agency from acquiring its goods and services from another agency's sole-source contract without having to justify a non-competitive procurement itself." FAR 6.303, which covers the justification requirements for using procedures other than competitive procedures, should incorporate that provision.

RESPONSE: **The concern expressed in this comment is covered under FAR 6.002, "Limitations," which states, "No agency shall contract for supplies or services from another agency for the purpose of avoiding the requirement of this part."**

7. (FAR 6.303-1(c)). FAR 6.303-1(c) permits justifications relating to the first six exceptions from competitive procedures to be made on a class basis. Again, this provision runs contrary to our stated intent that "all determinations and decisions required for use of the exceptions to competitive procedures...are to be made on a case-by-case basis. Broad categories or classes of products and services cannot be exempt from competitive procedures." See page 1427 of the Conference Report.

RESPONSE: **As stated in our response to Comment 3 above, the regulation will be revised to ensure that each individual acquisition based on a class justification is within the scope of the class justification**

previously approved. Each individual contract action will be reviewed through this process to ensure that it complies with CICA.

8. (**FAR Part 7**). FAR Part 7 deals with acquisition planning. The predominant emphasis seems to be on acquisition planning for relatively complex or high-dollar procurements. We believe that this part should be revised to provide guidance for other than complex or high dollar procurements. The Conference Report states on page 1429 that the planning requirements in CICA apply to all procurements -- competitive and noncompetitive.

RESPONSE: Concur. We are looking at improving FAR Part 7 in this regard. FAR Part 7 is not intended to predominantly emphasize acquisition planning for relatively complex or high-dollar procurements. Under FAR 7.103, it is the responsibility of the agency head or designee to prescribe procedures "establishing criteria and thresholds at which increasingly greater detail and formality in the planning process is required as the acquisition becomes more complex and costly, specifying those cases in which a written plan shall be prepared." Part 7 recognizes that certain acquisitions may require more detailed and formal planning than other acquisitions, but does not negate the statutory requirements for acquisition planning. This is also reflected in the definition of "acquisition planning" in FAR 7.101 which is: "the process by which the efforts of all personnel responsible for an acquisition are coordinated and integrated through a comprehensive plan for fulfilling the agency need in a timely manner and at reasonable cost. It includes developing the overall strategy for managing the acquisition." (Emphasis added.)

9. (**FAR 10.002(b)**). FAR 10.002(b) requires that defense agencies include descriptions of agency requirements, whenever practicable, to be stated in terms of functions to be performed or performance required. This preference for functional or performance specifications over detailed design specifications is applicable government-wide, rather than just to defense agencies.

RESPONSE: Concur. Although it is not required by statute for civilian agencies, paragraph 10.002(b) will be rewritten to require it by regulation.

10. (**FAR 13.000(a) & 13.103(a)**). FAR 13.000(a) provides for a $10,000 small purchase threshold for civilian agencies, which was increased to $25,000 under the Office of Federal Procurement Policy Act Amendments of 1983 (P.L. 98-191). Below this threshold, FAR 13.103(a) states that small purchase procedures shall be used to the maximum extent practicable. This provision fails to emphasize CICA's requirement that "in using small purchase procedures, an executive agency shall promote competition to the maximum extent practicable." The regulation should reflect that requirement.

RESPONSE: Concur. FAC 84-5 reflected the $25,000 small purchase threshold in FAR 13.000. FAC 84-5 also provided, under FAR 13.106(b), Purchases over $1,000, "(c)ontracting officers shall solicit quotations from a reasonable number of sources to promote competition to the maximum extent practicable..." (13.106(b)(1)).

11. (FAR 15.804-2(a)(2)). FAR 15.804-2(a)(2) states that there are "relatively few instances" where certified cost or pricing data and inclusion of defective pricing clauses would be justified in awards between $25,000 and $100,000. While certified cost or pricing data are not required for negotiated contracts under $100,000, contracting officers are authorized under CICA to obtain such data and should not be discouraged from doing so, especially considering the spare parts problems.

RESPONSE: These words have been in the regulations for some time and were not affected by CICA. Contracting officers are not precluded from obtaining cost or pricing data where such data are determined necessary.

12. (FAR 15.804-2(a)(2)). For contracts under $25,000, moreover, FAR 15.804-2(a)(2) states that "the contracting officer shall not require certified cost or pricing data." This prohibition simply has no basis in statute.

RESPONSE: The limitation in FAR 15.804-2(a)(2) is designed to avoid the expense to the Government associated with requiring certification of cost or pricing data on small dollar value contract actions. This limitation on requiring certification is consistent with CICA amendments to 41 U.S.C. 254 and 10 U.S.C 2306 which afford agency heads discretionary authority concerning requiring cost or pricing data submission on actions below $100,000. It is also consistent with CICA language which encourages agencies to establish simplified procedures with respect to purchases of $25,000 or less. On such actions, contracting officers may and do obtain cost or pricing data (uncertified) where necessary to determine the reasonableness of the price offered.

13. (FAR Subpart 15.5). FAR 15.5, which deals with unsolicited proposals, needs to be revised to (1) limit noncompetitively awarded unsolicited proposals to those involving research, (2) define or provide guidance for applying the concept of "unique" referred to in 15.502, 15.503(c)(1), 15.560-2(a)(1), 15.507(a)(3), etc., and (3) place limitations on information that may be disclosed to only one or a few select potential contractors when others could also meet the agency's needs.

RESPONSE: Concur in part. In order to clarify that only unsolicited research proposals may be processed to a non-competitive award using the traditional procedures of FAR 15.5 (and previously in DAR 4-900) in accordance with P.L. 98-369, the coverage will be modified to more specifically address unsolicited research proposals. The coverage currently in FAR Subpart 15.5 complies with P.L. 98-369 and, in addition, recognizes that there are non-research "unsolicited" proposals that are submitted (as well as unsolicited research proposals not meeting the criteria in P.L. 98-369 and FAR 15.503(c)) and provides guidance to contracting officers on the requirements for handling these actions (at FAR 15.507) that essentially directs them to comply with FAR Parts 5 and 6. This coverage will, however, be modified to clarify that unsolicited proposals other than valid unsolicited research proposals may not be processed under the abbreviated procedure authorized by P.L. 98-369 as implemented at FAR 6.302-1(b)(3). Since the term "unique" is not given any special meaning in the law or regulation different than its normally understood definition, additional guidance concerning this term is not deemed necessary or appropriate.

14. (FAR 19.502-2). FAR 19.502-2 retains the "Rule of Two" provision, which we believe is no longer appropriate under CICA. The minimal standard for competition established by the "Rule of Two" provision runs contrary to section 16 of the Office of Federal Procurement Policy Act, as amended by CICA, which requires agencies "to increase the use of full and open competition...by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or proposals from responsive sources..." The Conference Report clearly states on page 1434 that this requirement applies to "all agency procurements, including those made under set-aside programs."

RESPONSE: We do not interpret the "Rule of Two" to be in conflict with CICA. Use of the rule contemplates full and open competition after a set aside decision has been made.

15. (FAR 4.6). The FAR does not incorporate the record requirements in CICA, which amend section 19 of the Office of Federal Procurement Policy Act. These provisions are required to be implemented on a government-wide basis.

RESPONSE: For the Department of Defense, DD Form 350, for NASA, Form 507, and for the civilian agencies, Standard Form 279 were all revised to comply with Section 19 of CICA. Information required by CICA is being collected by each executive agency on these forms and entered in the Federal Procurement Data System on a Government-wide basis.

16. (P.L. 98-577 and 98-525). Finally, the proposed FAR changes, of course, need to be revised in accordance with the provisions of P.L. 98-577 and P.L. 98-525.

RESPONSE: Concur. P.L. 98-525 and P.L. 98-577 amendments to CICA were implemented in FAC 84-5 (updated synopsis provisions) and FAC 84-6 (revised public comment provisions).

17. (FAR 5.002). FAR 5.002 (page 12). Suggest deleting the phrase "offering competitive opportunities for contractors and subcontractors." This phrase has been widely interpreted by contracting officials as requiring publicizing of contract actions only when they decide that competitive opportunities exist. (See GAO/PLRD-82-40, especially pages 30 and 31.)

RESPONSE: Concur. The quoted words will be deleted. The introductory phrase of FAR 5.002 as amended, will read: "Contracting officers shall publicize contract actions in order to..."

18. (FAR 5.202(a)(1)). FAR 5.202(a)(1) (page 13). Suggest revision to provide for the exception when "the synopsis for a contract action cannot be worded to preclude the disclosure of information which would compromise the national security. The fact that a contract action involves classified information does not, in itself, justify an exception."

RESPONSE: The language used is in compliance with P.L. 98-577. Any release of classified information in the CBD would compromise the national security. The decision to classify information (to avoid compromise of the national security) is made by individuals other than the contracting officer and is not reviewable by the contracting officer. Although the language of 5.202(a)(1) will be modified to more closely conform to P.L. 98-577, guidance concerning release of classified information is deemed necessary for understandable application of the regulation by contracting officers, and is not intended to broaden the use of the statutory exception in any way. The proposed coverage is as follows:

> **The synopsis cannot be worded to preclude disclosure of an agency's needs and such disclosure would compromise the national security (e.g., would result in disclosure of classified information). The fact that a proposed solicitation or contract action contains classified information, or that access to classified matter may be necessary to submit a proposal or perform the contract does not, in itself, justify use of this exception to synopsis.**

19. (FAR 5.202(a)(7)). FAR 5.202(a)(7) (page 13) needs clarification. Do the last four lines apply to proposals under SBIDA, too?

RESPONSE: Concur that clarification is required. The last four lines, regarding uniqueness and disclosure issues, were not meant to apply to SBIDA proposals. We will separate FAR 5.202(a)(7) into two items and renumber remaining items.

20. (FAR 5.203(c)). FAR 5.203(c) (page 14). Suggest the words "unilateral sole-source" be eliminated.

RESPONSE: The words "unilateral sole-source" orders under a basic ordering agreement are included in FAR 5.203(c) to cover a specialized type of acquisition. Synopses for orders other than unilateral sole source orders are addressed elsewhere in FAR 5.203. This is a case where the regulatory implementation attempts to capture as large a number of contract actions as possible. However, in view of this and other comments regarding these words we will consider further whether revision is necessary.

21. (FAR 5.301). FAR 5.301, line 4 (page 16). Suggest adding "any" before the word "subcontracts," per CICA, section 2732, amending section 18(a)(1)(B) of the OFPP Act.

RESPONSE: Concur. The coverage will be amended to clarify that contract awards over $25,000 must be synopsized if any subcontracts are likely.

22. (FAR 6.003). FAR 6.003 (page 19). Suggest revising the definition of full and open competition by adding the words "submit sealed bids or competitive proposals and" before the word "compete."

RESPONSE: The suggested language is too restrictive because under CICA there are other competitive procedures which are available in addition to sealed bids and competitive proposals as indicated in FAR 6.102, Use of competitive procedures.

23. (FAR 6.303-2(a)(6) or 6.303-2(a)(8)). FAR 6.303-2(a)(6) or (8) (page 23). Suggest adding at the end of this provision such words as, "including whether a CBD notice was publicized as required by FAR 5.2 and, if not, which exception under 5.202 applies." Otherwise, when publication of a CBD notice is not mentioned in the justification, reviewers will not know from reading it whether such notice was publicized.

RESPONSE: **Concur. We will add the suggested words to 6.303-2(a)(6).**

24. **(FAR 6.303-2(9)(ii), line 2.)** FAR 6.303-2(9)(ii), line 2 (page 23). Suggest adding "to the government" after "cost." (See FAR 6.302-1(b)(2) and CICA sections 2711 and 2723(d)(1)(B).)

RESPONSE: **Concur. The words "to the Government" will be added after "cost."**

25. **(FAR 6.304(a)(1)).** FAR 6.304(a)(1) (page 23). Suggest that the floor (i.e., the lowest dollar amount) to which this requirement applies, presumably $25,000, also be cited.

RESPONSE: **FAR Part 6 applies to all acquisitions with certain exceptions. One exception (see FAR 6.001(a)) is contracts awarded using the small purchase procedures of Part 13. As stated in Part 13, small purchase procedures are to be used to the maximum extent practicable for all purchases of supplies or services not exceeding the small purchase limitation ($25,000). When small purchase procedures are used, the acquisition is already outside Part 6 and, therefore, stating a dollar floor would be superfluous. However, when small purchase procedures are not used, there is no dollar limitation and Part 6 applies regardless of the dollar value of the acquisition. Nevertheless, in view of this and other comments regarding FAR 6.304, we will consider whether revision is appropriate.**

26. **(FAR 7.101).** FAR 7.101 (page 25, definition of market survey). It is not clear how the phrase "and the results of any market test recently undertaken" fits in. Suggest wording clarification.

RESPONSE: **The phrase in question appears in the definition of "market survey" contained in FAR 7.101. The phrase is included in the definition as an example of the type of testing of the marketplace which may occur. The policy statement in FAR 7.102 requires that agencies conduct market surveys in order to promote and provide for full and open competition. In addition, each justification for the use of other than full and open competition is required under FAR 6.303-2 to include a description of the market survey conducted and the results. Therefore, if a market test had recently been undertaken, this fact and the results of the test would have to be included in the justification.**

27. **(FAR 8.403-2).** FAR 8.403-2 (page 3). Contained a FAR revision adding a new second sentence, "All responsible offerors may submit offers in response to a solicitation for multiple-award schedule contracts." But the FAR instructions deleted this revision. Suggest that this revision be retained. (See CICA section 2711 amending FPASA section 309(b)(3) and CICA section 2721 amending 10 U.S.C. 2302(2)(C).) It is not clear why this revision was deleted.

RESPONSE: Part 8 of the FAR addresses only use of schedules (i.e., requirements for ordering activities). FAR Part 38 addresses development of schedules. The language cited is found at FAR 38.102-2(a).

28. (FAR 9.2 and FAR Part 11 - P.L. 98-577 and 98-525). Has FAR 9.2 (pages 34 and 35, revised) and FAR Part 11 (starting on page 39, revised) been revised to be consistent with Public Law 98-577 and, to the extent appropriate, the DoD fiscal year 1985 authorization act?

RESPONSE: Revised provisions for qualification requirements and commercial pricing for supplies appear in FAC 84-11 and 84-10 respectively.

29. (FAR 10.002(a)(4)). FAR 10.002(a)(4) (page 37). Obviously, something is missing here.

RESPONSE: Concur. The missing coverage was corrected and included in FAC 84-5 as enumerations (i), (ii) and (iii) under FAR 10.002(a)(4).

30. (FAR 13.103(b)). FAR 13.103(b), last line (page 42). Suggest "the use of" replace the words "negotiation under."

RESPONSE: Concur. The suggested wording will be adopted in the revised CICA coverage.

31. (FAR 13.204(c)). FAR 13.204(c) (page 45), revised). Suggest the proposed FAR revision be deleted. The earlier wording appears to be more appropriate.

RESPONSE: It is our view that use of the current wording, "purchasing from only one source," is broader and therefore preferable to the narrower wording, "sole source purchasing", since any non-competitive action is discouraged.

32. (FAR 14.101(e)). FAR 14.101(e) (page 49). Suggest the "and" before "other factors included" be deleted.

RESPONSE: Concur. FAC 84-5, paragraph 14.101(e) made the recommended change.

33. (FAR 14.103-2). FAR 14.103-2 (page 49). Suggest "unless" be added after sealed bidding.

RESPONSE: Concur. FAC 84-5, paragraph 14.103-2 made the recommended change.

34. (FAR 14.104 and 14.501). FAR 14.104, line 2 (page 49). Suggest changing "formal advertising" to "sealed bidding." Also see FAR 14.501, line 2 (page 65).

RESPONSE: Concur. FAC 84-5 made the recommended change to both FAR citations.

35. (FAR 14.201-7(b)(1)). FAR 14.201-7(b)(1), line 1 (page 52). Suggest adding "sealed bidding" after "by."

RESPONSE: Concur. FAC 84-5, paragraph 14.201-7(b)(1) made the recommended change.

36. We could not find some of the information in FAR references. For example:

-- (FAR 14.203-1). (page 55) refers to 5.102(c)(1).

RESPONSE: Concur. FAC 84-5 corrected the reference to read "5.102."

-- (FAR 14.404-1(e)(1)). (page 59) refers to 15.103, which is "reserved."

RESPONSE: FAR 15.103 is no longer reserved, its title as printed in FAC 84-5 is now, "Converting from Sealed Bidding to Negotiation Procedures." The reference in FAR 14.404-1(e)(1) to 15.103 is correct.

-- (FAR 36.103(a)). (page 143, revised) refers to 6.003(a) and 6.003(b)(2).

RESPONSE: Concur. FAC 84-5 corrected the references in 36.103(a) to read 6.401(a) and 6.401(b)(2) respectively.

-- (FAR 36.601). (page 147, revised) refers to 6.102(c)(1).

RESPONSE: Concur. FAC 84-5 corrected the reference in 36.601 to read 6.102(d)(1).

-- (FAR Subpart 38.1). (page 150, revised) shows a paragraph (c) to be inserted (but it does not indicate where). The insert refers to FAR 6.103.

RESPONSE: Proposed paragraph (c) in the 1 October 1984 draft became paragraph 38.102-2(c) in FAC 84-5 and the reference therein was corrected to read 6.102(d)(3).

37. (FAR 15.502). FAR 15.502 (page 75). FAR policy only addresses unsolicited research proposals, but the definition of unsolicited

proposal is not limited to research. (Also, see comment number 1 on page 1 and comment number 11 on page 9, above.)

RESPONSE: Please see our response to Comment 13, above.

38. (FAR 15.503(c)(5)). FAR 15.503(c)(5) (page 75). The meaning of "documented" is unclear. Will this wording permit noncompetitive awards simply because known requirements were not "documented" in some specific way defined by agencies' internal procedures?

RESPONSE: FAR 15.507(a)(2)) was changed to reflect CICA language that unsolicited proposals should not be accepted if they resemble the substance of pending procurement requests. However, we will review the language in 15.503(c)(5) to determine if a revision is necessary.

39. (FAR 15.1001(a)). FAR 15.1001(a) (page 96). Suggest adding the word "promptly" before "notify." (See CICA, section 2711 amending FPASA section 303B(d)(4) and CICA section 2723 amending ASPA section 2305(b)(4)(D).)

RESPONSE: Concur. The word will be added.

40. (FAR 17.6). Should FAR 17.6 be revised based on CICA? For example, see 17.604(c).

RESPONSE: In accordance with its terms (FAR 17.602(a)) Subpart 17.6 limits use of these procedures to agencies specifically authorized by statute to enter into management and operating contracts. FAR 17.6 will be revised as necessary to clarify that CICA (Part 6) applies to such contracts.

41. (FAR 19.502-4(a)). FAR 19.502-4(a) (page 114). Suggest "Whenever possible" be changed to "Whenever appropriate."

RESPONSE: Partially concur. To avoid possible misunderstandings between "possible" and "appropriate," we decided that neither phrase should appear in FAC 84-5 and we therefore deleted the words "whenever possible."

42. FAR 34.002(b) and 34.005-1(a)). FAR 34.002(b) and FAR 35.005-1(a) (page 139). Suggest that the references to "effective" competition be deleted (while retaining the references to Part 6 and full and open competition).

RESPONSE: We do not agree that it would be beneficial to delete the references to "effective" competition. Effective competition is result oriented and exists when competitive market forces result in the lowest cost alternative to the Government or the best technical design meeting the Government's minimum needs. Because the present coverage uses the terms "effective" competition and "full and open" competition conjunctively, both requirements are applicable in major system acquisition.

43. (FAR 44.302(a)). FAR 44.302(a) (page 153) deletes some wording relating to modifications. It is not clear why.

RESPONSE: The proposed coverage which was originally disseminated for public comment deleted the words "and modifications to competitively awarded contracts and formally advertised contracts." FAC 84-5 later added back in the words "and modifications" so that the dollar value of modifications (other than those when the negotiated price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or is set by law or regulation) will be included in the contractor's business base when determining whether a contractor purchasing system review (CPSR) is to be conducted. The proposed coverage deleted too many words.

44. (FAR Part 52, Table of Contents). FAR Part 52, table of contents, item 52.214-3 (page 162). Why is "Invitations for Bids" changed to "Request for Sealed Bids?"

RESPONSE: The change of "Invitation for Bids" to "Request for Sealed Bids" was not intended and was included inadvertently. This change was considered, but was later rejected as unnecessary and an undue implementation burden on the federal procurement community (the myriad of references to this form at all levels and the changes to the forms themselves).

Responses to 19 July 1985 Letter

1. (FAR 4.6). Although FAR 4.6 has not been revised, it refers to the "FPDS manual;" but the new Federal Procurement Data Center (FPDC) instruction implementing CICA does not revise the manual.

RESPONSE: For the Department of Defense, DD Form 350, for NASA, Form 507 and for the civilian agencies, Standard Form 279, were all revised to comply with Section 19 of CICA. Information required by CICA is being collected by each executive agency on these forms and entered in the Federal Procurement Data System on a Government-wide basis. Although revision to the Federal Procurement Data Center's operating procedures and manuals is not a matter within the cognizance of the FAR system, your concerns have been transmitted to the Federal Procurement Data Center for necessary action.

2. (FAR 4.6). The new instruction relating to the Federal Procurement Data System (FPDS) form calls for reporting (1) one offer and (2) more than one offer; but "responsible" is not mentioned.

RESPONSE: Assuming an agency uses competitive procedures and receives only one offer, the contract awarded to the sole offeror would be awarded to the "one responsible source." The information required by Section 19(c) is therefore being provided even though "responsible" is not specifically mentioned in implementing agency procedures. FPDS procedures are not, in any event, within the cognizance of the FAR System.

3. (FAR 4.6). The 5-year retention period is not mentioned in the FAR, FPDS manual, or FPDC instruction.

RESPONSE: Since instructions for retention of records by the Federal Procurement Data Center is the responsibility of that Center, such instructions should therefore properly be included in FPDC manuals or operating instructions rather than in the FAR.

4. (FAR 5.207(b)(4)). FAR mentions QPL but not "offeror" qualification requirements.

RESPONSE: Concur. FAR 5.207(b)(4) will be revised to reflect the requirements of P.L. 98-577 that the synopsis contain a provision that reflects whether the solicitation requires that an offeror, its product, or service must meet a qualification requirement in order to be eligible for award, and that further identifies the office from which additional information about the qualification requirement may be obtained.

ATTACHMENT #2

5. (FAR 5.202(a)(1)). Should the FAR (Commerce Business Daily (CBD) notice) exception be rewritten to conform to the statute (national security exception)?

RESPONSE: Concur. See our response to Comment 18, Attachment #1.

6. (FAR 5.202(a)(7)). Should the FAR (CBD notice) exception include (at the end): "or would disclose proprietary information associated with the proposal"?

RESPONSE: Concur. The exception at 5.202(a)(7) will be divided into two exceptions — one dealing with P.L. 97-219 actions and the other addressing unsolicited research proposals. The words suggested will be added to the end of the latter exception.

7. (FAR 5.201(b) and 5.205(c)(2)). What is the legal basis for generally exempting from the CBD notice requirement all proposed contract actions to be made outside "the U.S., its possessions or Puerto Rico" (5.201(b)) as well as architect - engineering services specifically (5.205(c)(2)?

RESPONSE: The authority for the use of this language is Section 18(c)(3) of the OFPP Act and 15 U.S.C. 637(g)(3), (Section 8 of the Small Business Act as amended by P.L. 98-577).

Prior to passage of P.L. 98-369 (CICA), the same language, which was in the FAR and all predecessor federal procurement regulations (FPR, DAR/ASPR) was authorized by language in the Small Business Act (15 U.S.C. 637(e)). In the development of FAR coverage implementing P.L. 98-369 by the DAR Council and CAA Council, prior to enactment of P.L. 98-577, the Councils were faced with two differing laws addressing public notice requirements (15 U.S.C. 637(e) and Section 18 of the OFPP Act). The new OFPP Act coverage did not contain the language "...from any Federal department, establishment, or agency engaged in procurement of supplies and services in the United States..." (emphasis added), but authorized an exception where the head of an agency determines in writing that it is not appropriate or reasonable to publish a notice before issuing a solicitation and obtains concurrence from the Administrator, OFPP. On behalf of the FAR System and the participating agencies thereunder, the Director of the DAR Council and the Chairman of the CAA Council prepared such a determination and forwarded it to the Administrator, OFPP. On 26 September 1984, Mr. Donald E. Sowle responded: "I concur in the above request to exempt from synopsis in the CBD proposed contract actions by agencies engaged in procurement outside the United States and for utility services when only one source is available."

Later, when P.L. 98-577 was enacted, it was not immediately recognized by the Councils that the enabling language of the Small Business Act had been removed. Subsequently however, it was determined that "consultation" (the replacement for "concurrence" inserted by P.L. 98-577) had been achieved informally by the Chairman, CAA Council, and due to the fact that the SBA is represented on the CAA Council.

In general, the determination recognized, consistent with longstanding practice, that synopsis of proposed contract actions to be entered into and performed outside the United States generally serves no useful purpose, would unduly delay such contract actions (due to the waiting periods), and would confuse U.S. firms. Current practice in our overseas contracting offices is to synopsize all contract actions where U.S. sources are desired to participate. In DoD contracting activities overseas, nearly all requirements for supplies are sent to the U.S. for procurement action and normal synopsis practices are followed. Generally, it is services, subsistence and construction that are contracted for locally.

The regulation will be revised to clarify the specific overseas situations when synopsis is not required (e.g., awarded and performed overseas, only local sources will be solicited). It should be recognized that full and open competition and competitive procedures are still required to be used (except where one of the circumstances of FAR 6.302 must be applied).

8. (FAR 6.302-1(b)(4)). The FAR example covers the first half of the CICA exception to competition but not the second: "no other type of property or services will satisfy the needs of the executive agency."

RESPONSE: Please see our response to Comments 1 and 3 within Attachment #1.

9. (FAR 15.804-2(a)(1)(ii)&(iv)). Shouldn't the FAR contain the following provision after "$100,000": "or such lesser amount as may be prescribed by the agency head"?

RESPONSE: In this regard, the discretion afforded the agency head by CICA to require certified cost or pricing data in contract actions below $100,000 has been implemented within FAR 15.804-2(a)(2), which allows contracting officers to obtain such data when appropriate.

10. (FAR 15.1001(a)). Does this FAR provision conflict with CICA? CICA's bid protest provisions and the fact that notice to unsuccessful offerors often provides a basis for protests increase the importance of such notice.

RESPONSE: Concur. The exceptions to the requirement for notifications to unsuccessful offerors were inadvertently retained in this provision. Appropriate changes will be made when the final rule is promulgated.

11. (FAR 34.005-1(a)). FAR language could be interpreted to limit "full and open competition." Also, should a reference to FAR Part 6 be added?

RESPONSE: Please see our response to Comment 42, Attachment #1. A reference to FAR Part 6 is contained in the Policy paragraph (34.002) and is automatically applicable to all such acquisitions.

12. (FAR 15.502). In addition, we noted two places in the FAR that appear to contain typographical errors:

-- FAR 15.502, line 1 - "that" instead of "shall"?

RESPONSE: Concur. The correct word is "shall."

-- FAR 34.003 - heading is missing after 34.002(b).

RESPONSE: Concur. The title is "Responsibilities."

This is not an [illegible] review.
We received this as a result of
the request for comments.

Review of Legislation Affecting Rule of Two or More

Our review of The "Rule of Two or More" has included the following legislative references which have a bearing on this rule:

a. Sec. 221(j) of Public Law 95-507 which states in part, "(j) Each contract for the procurement of goods and services which has an anticipated value of less than $10,000 and which is subject to small purchase procedures shall be reserved exclusively for small business concerns unless the contracting officer is unable to obtain offers from two or more small business concerns that are competitive with market prices and in terms of quality and delivery of the goods or services being procured..." (Underscoring added).

Comment:

This section of the law specifically quantifies the sufficiency of competition required to reserve a procurement for exclusive participation by small business concerns.These reservations are now known as small business small purchase set-asides.

b. Public Law 98-369 (TITLE VII - COMPETITION IN CONTRACTING) states at:

"(1) Sec. 303(b)(2). In fulfilling the statutory requirements relating to small business concerns and socially and economically disadvantaged small business concerns, an executive agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to compete." (Underscoring added).

Comment: This section of the law shows that small business set-asides are determined to be competitive type procurements by use of the term "competitive procedures" which the law defines as full and open competition. See Comment (7) below.

(2) "Sec. 2301(b)(3) promote responsiveness of the procurement system to agency needs by simplifying and streamlinig procurement processes."

Comment: This section of the law recognizes the need for improvements to be made to the procurement process. One of these improvements which must be made is the increased use of automation to process more rapidly and efficiently the 14.8 million contract actions made annually by DoD contracting activities. In order to exploit the advantages of automation, a precise quantification of the sufficiency of competition is mandatory, therefore, the necessity for the "rule of two or more."

(3) "Sec. 2301(c). Further, it is the policy of Congress that a fair proportion of the purchases and contracts entered into under this chapter be placed with small business concerns."

Comment: This section of the law established the doctrine and national policy that a "fair proportion" of an agency's purchases and contracts shall be awarded to small business conerns.

(4) "Sec. 2302(3). The terms "full and open competition" and "responsible source" have the same meanings provided such terms in section 4 of The Office of Federal Procurement Policy Act (41 U.S.C.403)"

Comment: See comments at b.(1),(6),(7) and (8).

(5) "Sec. 2373(a)(2) "In determining the competitive procedure appropriate under the circumstances, the head of an agency -

"(A) shall solicit sealed bids if -

(iv) there is a reasonable expectation of receiving more than one sealed bid; and"

Comment: The language in this section of the law clearly establishes that if "more than one sealed bid" has been received then the test of sufficiency of competition has been satisfied.

(6) "Sec. 2373(b)(2). In fulfilling the statutory requirments relating to small business concerns and socially and economically disadvantaged small business concerns, the head of an agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to participate."

Comment: This section of the law establishes two facts: (1) that set-asides are an authorized means of procurement and, (2) that set-asides are awards made under competitive procedures and that such competitive procedures are considered to be "full and open competition" as per Sec. 2371 cited below.

(7) "Sec. 2301(a)(3)(C) a determination that the anticipated cost will be fair and reasonable."

Comment: This section of the law shows that not the "lowest" cost must be obtained but rather a "fair and reasonable" cost must be obtained.

(8) "Sec. 2371(3) by adding at the end thereof the following new paragraphs:

"(6) the term 'competitive procedures' means procedures under which an agency enters into a contract pursuant to full and open competition;

"(7) the term 'full and open competition,' when used with respect to a procurement, means that all responsible sources are permitted to submit sealed bids or competitive proposals on the procurement; and

"(8) the term 'responsible source' means a prospective contractor who -

"(A) has adequate financial resources to perform the contract or the ability to obtain such resources;

"(B) is able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and Government business commitments;

"(C) has a satisfactory performance record;

"(D) has a satisfactory record of integrity and business ethics;

"(E) has the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain such organization, experience, controls, and skills;

"(F) has the necessary production, construction, and technical equipment and facilities, or the ability to obtain such equipment and facilities; and

"(G) is otherwise qualified and eligible to receive an award under applicable laws and regulations."

Comment:

The above terms of "competitive procedures," "full and open competition" and "responsible source" are all applicable to small business set-asides, i.e., whenever a procurement is conducted on a small business set-aside basis all elements of the definitions of these three terms are satisfied. The conditions which define a "responsible source" are conditions that all business firms, large and small, must meet in order to properly discharge their contract obligations regardless of the method of procurement.

(9) Sec. 21 (2) Section 16(1) of such Act (41 U.S.C. 414(1) is amended to read as follows:

> "(1) increase the use of full and open competition in the procurement of property or services of the executive agency of establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including

performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

Comment:

This section of the law using the imprecise term "sufficient" is not in accord or agreement with other sections of the law cited above which talk to precise quantification such as "two or more" (P.L. 95-507); "there is a reasonable expectation of receiving more than one sealed bid (Sec.2373(a)(2). Further Sec. 2319(d)(1) of P.L. 98-577 states "If the number of qualified sources or qualified products available to compete actively for an anticipated future requirements is fewer than two actual manufacturers..." The term "lowest reasonable cost" is not in accord or agreement with the term "fair and reasonable" used at Sec. 2301(a)(3)(C). The above cited language in 16(1) will result in problems of definition and application. The term "sufficient" should be replaced with the term "two or more" and the term "at the lowest reasonable" should be replaced with the term at "fair and reasonable."

c. The Conference Report 98-861 on the Deficit Reduction Act of 1984 established the following:

(5) COMPETITION REQUIREMENT

Senate amendment

The Senate amendment has no comparable provision.

Conference substitute

The conference substitute amends Section 16(1) of the OFPP Act (executive agency responsibilities) to require the use of full and open competition in executive agency procurements of property and services. Language contained in this substitute requires agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs.

Comment:

We do not believe that this language overtakes or nullifies the Federal Acquisition Regulation language "that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering products of different small business concerns and (b) awards will be made at reasonable prices." As noted above, the conference language is not in accord or agreement with other sections of the law as passed.

d. Congression Record dated October 2, 1984

(1) Page 10840

> "Other provisions of the Small Business Act and Competition in Contracting Act are addressed to ensure that all small business procurement programs are in no way impacted by the recent passage of Public Law 98-369."

(2) Page 10841

> "Finally, certain technical amendments are made to the Competition in Contracting Act - Public Law 98-369 -to ensure that the programs established by sections 9 and 15 of the Small Business Act are protected and are considered competitive procedures for purposes of the former statute. The section 8 (a) program is similarly protected by insuring that it too will not be impacted by the provisions of Public Law 98-369."

Comment:

Both of these remarks by the Chairman, Committee on Small Business House of Representatives express the intent that the small business programs are not to be adversely affected by the passage of P.L. 98-369.

e. Sec. 303(D)(d)(1) of Public Law 98-577 (Small Business and Federal Procurement Competition Enhancement Act of 1984) states:

> "If the number of qualified sources or qualified products available to compete actively for an anticipated future requirement is fewer than two actual manufacturers or the products of two actual manufacturers, respectively, the head of the agency concerned shall - " (Underscoring added).

Comment:

This is just another expression of quantifying the sufficiency of competition.

f. Sec. 504(b)(1) and (2) of Public Law 95-577 states in part:

> "(b)(1) Section 2304(b) of title 10, United States Code, is amended by striking out paragraph (2) and inserting in lieu thereof the following:
>
> (2) An executive agency may provide for the procurement of property or services covered by this section using competitive procedures, but excluding other than small business concerns in furtherance of sections 9 and 15 of the Small Business Act (15 U.S.C. 639; 644)."
>
> (3) A contract awarded pursuant to the competitive

procedures referred to in paragraphs (1) and (2) shall not be subject to the justification and approval required by subsection (f)(1)."

"(A) the Act of June 25, 1938 (41 U.S.C. 46 et seq.), popularly referred to as the Wagner-O'Day Act; or

(B) the authority of section 8 (a) of the Small Business Act (15 U.S.C. 637)."

(3) Section 2302(2) of such title is amended--

(A) by striking out "and" at the end of subparagraph (B);

(B) by striking out the period at the end of paragraph (C) and by inserting in lieu thereof a semicolon; and

(C) by adding at the end thereof the following new subparagraphs:

(D) procurements conducted in furtherance of section 15 of the Small Business Act (15 U.S.C. 644) as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete; and

(E) a competitive selection of research proposals resulting from a general solicitation and peer review or scientific review (as appropriate) solicited pursuant to section 9 of the Small Business Act (15 U.S.C. 638).:

Comment:

The above sections establish in law the authority to conduct set-asides by "competitive procedures" as long as all small business firms are permitted to compete.

g. Sec. 2319 (d)(1) "If the number of qualified sources or qualified products available to compete activity for an anticipated future requirement is fewer than two actual manufacturers or the products of two actual manufacturers, respectively, the head of the agency concerned shall- (Underscoring added).

(A) periodically publish notice in the Commerce Business Daily soliciting additional sources or products to seek qualification, unless the contracting officer determines that such publication would compromise national security;"

Comment:

The language in the law clearly establishes that when dealing with "fewer than two actual manufacturers" one is involved in a sole source situation. Conversely, when in dealing with "two or more" actual manufacturers one is involved in "competitive procedures".

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 11 1986

MEMORANDUM FOR JACK CARLEY

FROM: David
David F. Baker

SUBJECT: Small Business Set-Asides

Opposition - principally from the House Small Business Committee and various small business lobbying groups - is beginning to build in response to my instruction of February 21st, regarding replacement of the "rule of two" regulation. (Enclosed are various press releases to this effect, for your information.) There have been and continue to be numerous press and Congressional staff inquiries as a result of the OFPP instruction.

To familiarize our public affairs and Congressional liaison staffs with this issue, we have prepared a series of questions and answers which provide the background, rationale and probable effects of our action. I would appreciate your review of the attached to assure that you and I are in consonance on all aspects of this issue before the material is distributed. To be most useful, I would prefer to provide these questions and answers to Ed Dale, Bryce Harlow and other affected or interested OMB staff by this coming Friday (March 14th).

Thanks for your help.

Attachments

cc: Diane Weinstein

(Attachment A)

Revision to FAR Section 19.502-2

Total Set-Asides.

The entire amount of an individual acquisition or class of acquisitions .... shall be set aside for exclusive small business participation if the contracting officer determines that offers will be obtained from a sufficient number of responsible small business concerns to fulfill the government's requirements at the lowest reasonable cost considering the nature of the property or services procured.

The number of small business concerns from which it is expected that offers will be obtained must be justified as sufficient to result in final awards being made at the lowest reasonable cost to the Government, considering the nature of the property or service procured. Although no numerical standard may predetermine the set aside decision, it is anticipated that less than five offers will not usually be sufficient under this standard. Therefore, every set-aside based upon an expected number of bids below five must be specifically documented to show the circumstances justifying such lower number.

* * * *

[Changes are indicated by underscoring. Ten bids is the average number currently received at DoD; NASA averages eleven. Specific documentation of the reasons for a set-aside decision is curently required only if an acquisition is not set aside.]

(Attachment B)

Proposed Revision to FAR Part 6. Competition Requirements

1. Add: to Subpart 6.1 - Full and Open Competition, a new section 6.101 (c)

6.100 Scope of subpart.

This subpart prescribes the policy and procedures that are to be used to promote and provide for full and open competition.

6.101 (a)

10 U.S.C. 2304 and 41 U.S.C. 253 require, with certain limited exceptions (see Subparts 6.2 and 6.3), that contracting officers shall promote and provide for full and open competition in soliciting offers and awarding Government contracts.

6.101, (b)

Contracting officers shall provide for full and open competition through use of the competitive procedure or combination of competitive procedures contained in this subpart that is best suited to the circumstances of the contract action. Contracting officers must use good judgment in selecting the procedure that best meets the needs of the Government.

6.101 (c)

41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competititve proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, includng those made under set-aside programs.

[Underscored material is the new CICA language amending the OFPP Act, except the final sentence, which is taken verbatim from the conference report on CICA.]

2. Delete: Section 6.203(b) from Subpart 6.1 and renumber paragraphs (c) and (d) as (b) and (c).

Section 6.203(b) currently provides:

> No separate justification or determination and findings is required under this part to set aside a contract action for small business or labor surplus area concerns.

ADDITIONAL ISSUES RELATING TO THE FAR REGULATIONS IMPLEMENTING CICA

1. FAR 5.002 (page 12). Suggest deleting the phrase "offering competitive opportunities for contractors and subcontractors." This phrase has been widely interpreted by contracting officials as requiring publicizing of contract actions only when they decide that competitive opportunities exist. (See GAO/PLRD-82-40, especially pages 30 and 31.)

2. FAR 5.202(a)(1) (page 13). Suggest revision to provide for the exception when "the synopsis for a contract action cannot be worded to preclude the disclosure of information which would compromise the national security. The fact that a contract action involves classified information does not, in itself, justify an exception."

3. FAR 5.202(a)(7) (page 13) needs clarification. Do the last four lines apply to proposals under SBIDA, too?

4. FAR 5.203(c) (page 14). Suggest that the words "unilateral sole-source" be eliminated.

5. FAR 5.301, line 4 (page 16). Suggest adding "any" before the word "subcontracts," per CICA, section 2732, amending section 18(a)(1)(B) of the OFPP Act.

6. FAR 6.003 (page 19). Suggest revising the definition of full and open competition by adding the words "submit sealed bids or competitive proposals and" before the word "compete".

7. FAR 6.303-2(a)(6) or (8) (page 23). Suggest adding at the end of this provision such words as, "including whether a CBD notice was publicized as required by FAR 5.2 and, if not, which exception under 5.202 applies." Otherwise, when publication of a CBD notice is not mentioned in the justification, reviewers will not know from reading it whether such notice was publicized.

8. FAR 6.303-2(9)(ii), line 2 (page 23). Suggest adding "to the government" after "cost". (See FAR 6.302-1(b)(2) and CICA sections 2711 and 2723(d)(1)(B).)

9. FAR 6.304(a)(1) (page 23). Suggest that the floor (i.e., the lowest dollar amount) to which this requirement applies, presumably $25,000, also be cited.

10. FAR 7.101 (page 25, definition of market survey). It is not clear how the phrase "and the results of any market test recently undertaken" fits in. Suggest wording clarification.

11. FAR 8.403-2 (page 33). Contained a FAR revision adding a new second sentence, "All responsible offerors may submit offers in response to a solicitation for multiple-award schedule contracts." But the FAR instructions deleted this revision. Suggest that this revision be retained. (See CICA section 2711 amending FPASA section 309(b)(3) and CICA section 2721 amending 10 U.S.C. 2302(2)(C).) It is not clear why this revision was deleted.

12. Has FAR 9.2 (pages 34 and 35, revised) and FAR Part 11 (starting on page 39, revised) been revised to be consistent with Public Law 98-577 and, to the extent appropriate, the DOD fiscal year 1985 authorization act?

13. FAR 10.002(a)(4) (page 37). Obviously, something is missing here.

14. FAR 13.103(b), last line (page 42). Suggest "the use of" replace the words "negotiation under".

15. FAR 13.204(c) (page 45, revised). Suggest the proposed FAR revision be deleted. The earlier wording appears to be more appropriate.

16. FAR 14.101(e) (page 49). Suggest the "and" before "other factors included" be deleted.

17. FAR 14.103-2 (page 49). Suggest "unless" be added after sealed bidding.

18. FAR 14.104, line 2 (page 49). Suggest changing "formal advertising" to "sealed bidding". Also see FAR 14.501, line 2 (page 65).

19. FAR 14.201-7(b)(1), line 1 (page 52). Suggest adding "sealed bidding" after "by".

20. We could not find some of the information in FAR references. For example:

—FAR 14.203-1 (page 55) refers to 5.102(c)(1).

—FAR 14.404-1(e)(1) (page 59) refers to 15.103, which is "reserved".

--FAR 36.103(a) (page 143, revised) refers to 6.003(a) and 6.003(b)(2).

—FAR 36.601 (page 147, revised) refers to 6.102(c)(1).

—FAR Subpart 38.1 (page 150, revised) shows a paragraph (c) to be inserted (but it does not indicate where). The insert refers to FAR 6.103.

21. FAR 15.502 (page 75). FAR policy only addresses unsolicited research proposals, but the definition of unsolicited proposal is not limited to research. (Also, see comment number 1 on page 1 and comment number 11 on page 9, above.)

22. FAR 15.503(c)(5) (page 75). The meaning of "documented" is unclear. Will this wording permit noncompetitive awards simply because known requirements were not "documented" in some specific way defined by agencies' internal procedures?

23. FAR 15.1001(a) (page 96). Suggest adding the word "promptly" before "notify". (See CICA, section 2711 amending FPASA section 303B(d)(4) and CICA section 2723 amending ASPA section 2305(b)(4)(D).)

24. Should FAR 17.6 be revised based on CICA? For example, see 17.604(c).

25. FAR 19.502-4(a) (page 114). Suggest "Whenever possible" be changed to "Whenever appropriate".

26. FAR 34.002(b) and FAR 35.005-1(a) (page 139). Suggest that the references to "effective" competition be deleted (while retaining the references to Part 6 and full and open competition).

27. FAR 44.302(a) (page 153) deletes some wording relating to modifications. It is not clear why.

28. FAR Part 52, table of contents, item 52.214-3 (page 162). Why is "Invitations for Bids" changed to "Request for Sealed Bids"?

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

ACQUISITION AND
LOGISTICS

1-94

26 MAR 1986

Mr. David F. Baker
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Room 9001
New Executive Office Building
Washington, DC 20503

Dear Mr. Baker:

In response to your request, this confirms my telephone call to you on March 21, 1986, regarding publishing your proposed change to the "rule of two" in the Federal Register. As I stated, we are concerned about Office of Federal Procurement Policy (OPFF) not following the agreement that we had worked out as set forth in OFPP policy letter 85-1 dated August 19, 1985.

However, this is not the underlying reason for my statement to you that we prefer OFPP publish the proposed change to the "rule of two." It is clear that the proposed change will be controversial. Were we to publish the change, we anticipate receiving a number of objections and requests for justification for the change from small business supporters in the Congress. After discussing this with my colleagues in GSA and NASA, we concluded that, since you have been the proponent of the change, it would be preferable for you to publish the policy directly. Of course we would assist you in this where we could.

Sincerely,

Eleanor Spector

Eleanor R. Spector
Deputy Assistant Secretary of
Defense for Procurement

APPENDIX B.—LETTERS FROM OFPP FILES, SUBMITTED BY DAVID F. BAKER, ACTING ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

"A Copy of Any and All Notes, Memoranda, Telephone Logs and Writings ... That Are Within The Possession Of OFPP and Relate To Any Comment, Suggestion or Direction ... From Any Person Within the Employ Of OMB, That The 'Rule Of Two' Should Be Repealed Because of the Provisions Of The Competition In Contracting Act (CICA) ..."

Compiled: June 4, 1986

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 5 1984

MEMORANDUM TO: MARY ANN GILLEECE, DOD
ALLAN BERES, GSA
STU EVANS, NASA

FROM: DAVID A. STOCKMAN D. A. S.

SUBJECT: Response to Congressman Brooks

The attached letter from Congressman Brooks raises questions regarding the "rule of two" small business set-aside provisions in FAR 19.502-2. Please provide information on which to base a response to Mr. Brooks.

It is our view that, while the receipt of responsive offers from two responsible offerors has long been acceptable as evidence of adequate price competition for purposes of complying with P.L. 87-653, it is quite another matter to adopt a standard which limits the competitive field based on the presumption or possibility of competition but which in fact may not ensure either competition or reasonable prices. This appears to have been caused by confusion over the distinction between "competition" as an end result and "competitive procedures."

We would appreciate your response, including your position on changing FAR 19.502-2, by April 13, 1984.

JUN 6 1984

MEMORANDUM TO JOE WRIGHT

FROM: DON SOWLE

SUBJECT: "Rule of Two" (Subject of your 3:00 PM meeting)

1. Attached is the exchange of correspondence on this subject with Jack Brooks.

2. "Rule of Two" is a red herring, not the real issue.

3. The real issue is the Small Business Set-Aside Program. The statute requires that a "fair proportion of total" Federal purchases go to small business. The set-aside program was designed to help achieve this objective. The problem arises in those industries (e.g., architect-engineers and construction) that have many competitive small businesses. In these cases, a majority of the procurements are set-aside for small business.

4. Achieving a fair proportion overall for small business means that a disproportionate share is awarded in some areas, such as A-Es and construction. This approach is supported by the major procuring agencies, the SBA, the GAO, and the Courts.

5. 99% of the A-E industry is classified as small business. A "rule of 50" would not change the set-aside picture. Therefore, the A-Es cannot point to the "rule of two" as the root of their problem. A meaningful fix would be to change the size standards.

Attachment

cc:
OFPP File/Chron/Reading
✓Mr. Maraist
Mr. Sowle

OFPP:WMaraist:mbd 6/6/84

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

OCT 19 1984

MEMORANDUM FOR DAVID STOCKMAN
JOSEPH WRIGHT

FROM: Donald E. Sowle Don

SUBJECT: OFPP Weekly Activity Report

I. SIGNIFICANT EVENTS

A. "Rule of Two"

This morning, we received a critical letter from two House Small Business Committee members (Parren Mitchell and Berkley Bedell) on our Federal Register notice dealing with the "rule of two" and requesting that the notice be withdrawn. (We have previously received over two dozen letters from the Hill urging that the matter be published for review and comment.) We are developing a response to this morning's letter and will reply by November 2, as requested. We continue to believe the "rule of two" is valid but that industry was initially provided insufficient opportunity to comment on it.

cc:
OFPP File/Chron/Reading
✓Mr. Maraist

OFPP:WMaraist:mbd 11/6/84

NOV 6 1984

MEMORANDUM TO "RULE OF TWO" COMMENT FILE

FROM: BUD MARAIST

SUBJECT: Record of telephone comment from Jim Lewin on November 1, 1984

Jim Lewin called to ask why we published the "rule of two" in the Federal Register for comment. It is his view that the CICA settled the issue.

Jim pointed out the following section in the amendments to the OFPP Act, as well as the corresponding section in the conference report:

> (2) Section 16(1) of such Act (41 U.S.C. 414(1) is amended to read as follows:
> "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives "a sufficient number" of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".
>
> "The conference substitute amends Section 16(1) of the OFPP Act (executive agency responsibilities) to require the use of full and open competition in executive agency procurements of property and services. Language contained in this substitute requires agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs."

He said that it was the conferee's view that the "rule of two" should be replaced by a concept of a sufficient number to fulfill requirements at the lowest reasonable cost. This represents a flexible standard that could vary from product to product or service to service. Each proposed set-aside should be evaluated using a standard evaluation that goes to heart of the issue - and that is, "will the resulting competition produce the lowest reasonable cost to the Government?" He feels that having a fixed number (2) standard does not do that.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

NOV 16 1984

MEMORANDUM FOR DAVID STOCKMAN
JOSEPH WRIGHT

FROM: Donald E. Sowle

SUBJECT: OFPP Weekly Activity Report

I. SIGNIFICANT EVENTS

F. FAR Rule-of-Two

Because of the concern expressed by 30 Congressmen and Senators, we are requesting public comment on the FAR "rule-of-two" standard for making small business set-aside determinations. Congressmen Parren Mitchell and Berkley Bedell requested, however, that we rescind the Federal Register notice for comment. We responded that we would leave the issue open for public comment based on our commitment to be open to the public on any policy issue of concern. We have received follow-up correspondence from Mitchell and Bedell on the same issue. At the same time, we are receiving staff input from the House Government Operations Committee stating that the Competition in Contracting Act has changed the "rule-of-two" standard to a "sufficient number" standard. These positions (that of the Government Operations Committee and that of the House Small Business Committee) are 180 degrees apart. Our response to Mitchell and Bedell will request a joint position from the Committees on the impact of the Competition in Contracting Act on the "rule-of-two".

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

NOV 23 1984

MEMORANDUM FOR **DAVID STOCKMAN**
JOSEPH WRIGHT

FROM: **Donald E. Sowle** Don

SUBJECT: **OFPP Weekly Activity Report**

I. SIGNIFICANT EVENTS

D. "Rule of Two"

Congressman Parren Mitchell had requested that our Federal Register notice for comment on the "rule of two" be rescinded. Since we declined, he is now requesting that the comment period be extended for 30 more days to give small businesses sufficient time to respond. We are extending the comment period as requested. Our response to Congressman Mitchell also explains that other committees are expressing an opposite view with respect to the Congressional interest on the "rule of two". We are requesting a joint position from the conferees on the "Competition in Contracting Act" which some say settles the issue.

84-621
Marine
Mathis
Baker

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

RECEIVED OFPP
84 NOV 29 A11:17

November 28, 1984

NOTE FOR: DON SOWLE

FROM: JOE WRIGHT Joe

SUBJECT: Rule of Two Regulation

Don -- I am very concerned about the way this "Rule of Two" regulation is proceeding -- I understand that you have extended the comment period from the end of November to the end of December. Why was that done?

Wouldn't it make sense to have the "Rule of Two" apply to only the smaller dollar contracts -- say, $100,000 and below? And then allow full competition by all sizes of firms for anything over that amount?

I hate to get into an issue like this, but we continue to get calls and comments. Thanks.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

DEC 6 1984

MEMORANDUM FOR: JOE WRIGHT

FROM: Don Sowle Don

SUBJECT: Your note on the "Rule of Two" Regulations

The architect-engineer (A-E) community is currently engaged in a concerted effort to change the FAR "rule of two" which requires small business set-asides when there are two or more small businesses eligible to compete and reasonable prices will result. The A&E's are particularly concerned because over 97% of all A-E firms (some 30,000 in number) are classified by SBA as small businesses. Those concerned with the rule of two are interested in reducing the number of small business set-asides, but this is difficult because nearly the entire industry is classified as small and the competition is keen. The A&E's have been unsuccessful in convincing SBA to change the size standard so they are attacking the problem indirectly by zeroing-in on the "rule of two".

This "rule" was developed to implement the Small Business Act requirement that a fair proportion of total purchases be placed with small business concerns. The majority of the dollars go out for major systems for which small firms cannot compete. Therefore, to achieve a fair proportion of total sales, agencies must concentrate on those products and services where small businesses are competitive.

The "rule of two" is currently in the FAR because the procuring agencies, the SBA, the Small Business Committees, the GAO and the courts all are in agreement that it is an appropriate implementation of the Small Business Act. It also has been successful for many years in DOD.

Some facts you should know:

- We are requesting public comment because of complaints that the FAR process did not properly air this issue.

Joe, to put this in perspective, A+E's are only about 4% of the total set-aside program. Don

- o We extended the comment period at the request of Congressmen Parren Mitchell and Berkley Bedell to give small business a fair opportunity to comment.

- o Some Congressional staff say that the Competition in Contracting Act and the Conference Committee Report settled the issue. In our response to Congressmen Mitchell and Bedell we asked for a statement of Congressional intent from the Conference Committee participants.

Our present position is that, although we support the rule of two or more, we will wait until after the public comment period to evaluate all comments. We will also wait for a response from Congressmen Mitchell and Bedell on the impact of the Competition in Contracting Act on the rule of two.

OFFICE OF MANAGEMENT AND BUDGET
OFFICE OF FEDERAL PROCUREMENT POLICY

FEDERAL ACQUISITION REGULATION (FAR) "RULE OF TWO"

AGENCY: Office of Management and Budget

ACTION: Notice for comment.

SUMMARY: The purpose of this notice is to solicit the views of all interested parties in both the public and private sector on the "rule of two" in Part 19 of the Federal Acquisition Regulation (FAR).

DATE: Comments are due on or before November 30, 1984.

FOR FURTHER INFORMATION CONTACT: William Maraist, Office of Federal Procurement Policy, OMB, (202-395-3300).

SUPPLEMENTARY INFORMATION: Although not new, the so called "rule of two" in FAR Part 19 has generated considerable controversy. The primary criticism is that this provision of the regulation did not receive adequate public notice and availability for comment.

The "rule of two" appears in FAR 19.502 which provides the requirements for setting aside acquisitions for small business:

> "19.502 Setting aside acquisitions
> "19.502-1 Requirements for setting aside acquisitions.
> Using the order of precedence in 19.504, the contracting officer shall set aside an individual acquisition or class of acquisitions when it is determined to be in the interest of (a) maintaining or mobilizing the Nation's full productive capacity, (b) war or national defense programs, or (c) assuring that a fair proportion of Government contracts is placed with small business concerns, and when the circumstances described in 19.502-2 or 19.502-3(a) exist.
>
> "19.502-2 Total set-asides.
> The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business—small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as a partial set asides). Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

As shown above, the "rule of two" is part of the standard of competitiveness required before an acquisition may be set aside for small business - "a reasonable expectation that offers will be obtained from at least two responsible small business concerns ... and awards will be made at reasonable prices." This standard was contained in the Defense Acquisition Regulation (DAR) and the NASA Procurement Regulation prior to the publication of the FAR. The Federal Procurement Regulations (FPR) coverage on set-asides, on the other hand, included a "sufficient number" standard. The FAR is essentially a consolidation of these two primary regulations. The drafters displayed the DAR and FPR coverages in side-by-side columns, and the proposed FAR coverage in a third column. These drafts were then made available for public comment. In the case of the set-aside provisions in question, the "sufficient number" standard was initially proposed for the FAR. Five of the six comments (including those of DOD, GSA, NASA and SBA) received on this provision requested that the language be amended to include the more specific criteria contained in the DAR (i.e., two or more) for determining if small business competition is available. The sixth comment requested added language to the effect that the set-aside would not impair agency mission or program requirements. Because contracting officers in the civil agencies had not consistently applied the "sufficient number" standard, and because the "rule of two" had worked well in DOD for more than five years as well as in NASA, the three regulatory agencies decided, in the final review phase, that the most workable standard for total set-asides was the "rule of two." "Sufficient number" as a standard provides little or no substantive guidance.

One of the issues raised by those who have criticized the "rule of two" is that in certain industries or product lines a disproportionate share of the Government's business is set-aside for exclusive participation by small businesses. However, this does not result from the "rule of two." The key to this issue is in the Small Business Act (15 USC 644) requirement that "... a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns ...". Fair proportion is tied in the statute to total purchases and contracts made by the Government. The bulk of Federal expenditures are for major systems which, at the prime contract level, are unavailable to small business. Therefore, ensuring that small business receives a fair proportion of the total Government contracts practically dictates that a disproportionate share must be awarded to small business outside of the major systems area.

This is to be expected when there are many small businesses in a given industry sector. The experience of the major procuring agencies indicates that the result would not change, even if "sufficient number" or some other standard were substituted for the "rule of two." The agencies report substantial competition in the small business set-aside program with an average of ten or more competitors on each procurement. Therefore, the issue is not the method of determining whether there is adequate competition among small businesses. Rather, it appears to be whether the situation should be allowed to continue which results in such disproportionate shares of Federal requirements for particular products or services being set-aside for small business?

We believe that the FAR language complies with current law and reflects the will of the Congress as expressed in the Small Business Act. This method of implementing the fair proportion of total contracts has been upheld by the Courts and the Comptroller General.

COMMENTS: All interested parties are invited to comment on the issue of the most appropriate standard for determining competitiveness in making a small business set-aside determination (e.g., rule of two, sufficient number, other standard). Comments should not be sent on the related issue of setting small business size standards. Small business size standards are set by the Small Business Administration and do not fall within the procurement policy authority of the Administrator for Federal Procurement Policy. Comments should be forwarded to William Maraist, Office of Federal Procurement Policy, OMB, 726 Jackson Place, Washington, DC 20503 on or before November 30, 1984. Mr. Maraist may be contacted by phone on 202-395-3300.

DONALD E. SOWLE
Donald E. Sowle
Administrator

Dated: OCT 3 1984

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM January 7, 1985

TO: Joe Wright

FROM: Mike Horowitz

RE: Rule of Two

The Washington Post's Federal Report item on Friday belatedly brought to my attention an issue which has apparently been percolating in the halls of OMB and OFPP for some time -- the legality of the "rule of two" now applied in set-aside decisions under new FAR 19.502-2.

After looking at the statute and its legislative history, I am convinced that the Brooks-Horton-Cohen-Levin view of the law is correct -- the rule of two is inconsistent with the new standard enacted by the Competition in Contracting Act of 1984, Title VII of the Deficit Reduction Act of 1984, P.L. 98-369 (CICA). Consequently, I propose a new approach to the matter, which would revise the offending FAR by simply reciting verbatim the new CICA standard. Such an approach would focus, not simply on whether the FAR rule of two should be replaced by the "sufficient number of bids" standard established in CICA but, more critically, on another, more important aspect of the controversy. That issue is whether the contracting officer must determine, not merely that the awards will be made at "reasonable rates" -- the current FAR standard -- but that they will result in awards "at the lowest reasonable cost," the second prong of the new CICA standards, which the legislative history explicitly makes applicable to set-asides.

The Small Business Act (15 USC 644) authorizes the use of set-aside procurement for small businesses when it is determined to be (1) in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) in the interest of war or national defense programs, (3) in the interest of assuring that "a fair proportion of total purchases and contracts for property and services for the Government are placed in small business concerns" or (4) in assuring that "a fair proportion of the total sales of Government property be made to small business concerns."

Revisions to the FARs were published in September, 1983 to be effective on April 1, 1984.

FAR 19.502-2 provides that an individual acquisition or class of acquistions "shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable rates." (Emphasis added.)

On March 14, 1984 Congressman Brooks wrote to the Director complaining that the "rule of two" set-aside provisions in the final FAR 19.502-2 rule (1) were not included in the version that went out for public comment and (2) violate the law.

Don Sowle's May 30, 1984 response to Brooks understandably focused almost exclusively on whether the FAR properly implements the Small Businesss Act, contending that the "issue is not the method of determining the existence of adequate competition among small businesses" but, rather, the propriety of set asides, which he felt had been resolved by Congress in the Small Business Act in favor of "non-procurement related public policies (socio-economic goals)."

CICA, Title VII of the Deficit Reduction Act of 1984, contains several provisions relating to competition in procurement, amending both the Federal Property and Administrative Services Act of 1949 and the Office of Federal Property Procurement Act.

The CICA amendment to Section 16 of the OFPP Act was a conference committee substitute. It mandates that executive agencies increase the use of "full and open competition" in procurement by "establishing ... procedures ... that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The conference report explains that this language is applicable when agencies are "using competitive procedures" and that the requirement "applies to all agency procurements, including those made under set-aside programs." (Note that old FPR 1-1.706-5 permitted total set asides under a "sufficient number" standard.)

The relevant CICA amendments to the FPASA are contained in Sections 303(b)(2) and 303(c). Section 303(b)(2) states:

> "In fulfilling the statutory requirements relating to small business concerns and socially and economically disadvantaged small business concerns, an executive agency shall use competitive procedures but may restrict a solicitation to allow only such business concerns to compete."

Sections 303(c), which lists the occasions when an agency may use other than competitive procedures, does not except small business set-asides.

Although there is no explicit reference to replacing the "rule of two" in the statute or its legislative history, the appended joint letter of Senators Cohen and Levin and Congressmen Brooks and Horton asserts that the "rule of two" provision "runs contrary to" Section 16 of the OFPPA.

On the other side, Congressman Mitchell maintains that the rule of two is per se competitive under current law, citing Section 303(a)(2) of FPASA and the parallel Section 2304(a)(2) of the Armed Services Procurement Act. Section 303(a)(2) of FPASA states that in determining the competitive procedures appropriate under the circumstance, an executive agency is required to solicit sealed bids if:

> "(A)(i) time permits the solicitation, submission, and evaluation of sealed bids;
>
> (ii) the award will be made on the basis of price and other price-related factors;
>
> (iii) it is not necessary to conduct discussions with the responding sources about their bids; and
>
> (iv) there is a reasonable expectation of receiving more than one sealed bid; and
>
> (B) shall request competitive proposals if sealed bids are not appropriate under clause (A).

Of course, Section 303(a)(2)(A) relates to the standards for soliciting sealed bids, and not to whether the procedure as a whole is competitive, as is clear from reading the immediately following subsection (B), which requires "competitive proposals" when sealed bids are not appropriate. In any event, it is clear that the numerical aspect of the rule of two was never the sole standard for competiveness; in addition, there had to be the likelihood of obtaining a reasonable rate.

Clearly, in many instances competitiveness (the lowest reasonable cost) may be assumed on the basis of only two bids. However, the crucial test is competitiveness, not some arbitrary number greater than one. Therefore, what I would propose to do would be merely to substitute "lowest reasonable cost," the newly-mandated Congressional standard, for "reasonable rate."

Proposed FAR revisions:

"19.502-2 Total set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business -- small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from a sufficient number of responsible small business concerns offering the products of different small business concerns and (b) awards will be made at the lowest reasonable cost. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as to partial set-aside).

19.502-3 Partial set-asides

(a) The contracting officer shall set aside a portion of an acquisiton, except for construction, for exclusive small business participation when ---

(1) ....;

(2) ...;

(3) A sufficient number of small business concerns are expected to have the technical competence and productive capacity to satisfy the set-aside portion of the requirement at the lowest reasonable cost;

(4) ...; and

(5) .

(Revisions are indicated
by underscoring.)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 11 1985

MEMORANDUM FOR: WILLIAM MATHIS

FROM: William S. Coleman, Jr.
William S. Coleman, Jr.

SUBJECT: Rule of Two

You have requested our analysis of the impact of the Competition in Contracting Act of 1984 (CICA) (P.L. 98-369) on Subpart 19.502-2, "Total Set-Asides," of the Federal Acquisition Regulation (FAR).

Analysis

Subpart 19.502-2 of the FAR establishes the "rule of two" as the threshold criterion for determining whether to set-aside a procurement action for exclusive small business participation. The pertinent FAR language is as follows.

> The entire amount of an individual acquisition or class of acquisitions ... shall be set-aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible, small business concerns offering products of different small business concerns; and (b) awards will be made at reasonable prices. Total set-aside shall not be made unless such reasonable expectation exists.

The FAR provision constitutes the executive branch implementation of Section 15 of the Small Business Act (15 USC 644), which requires that contracting agencies ensure that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns.

Congress' intent, as expressed in these provisions of the Small Business Act, is confirmed in recent amendments to the Federal Property and Administrative Services Act (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Procurement Policy Act (OFPP), as set forth in the CICA and the Small Business and Federal Procurement Competition Enhancement Act of 1984 (P.L. 98-577).

title 10 USC

Section 2301(c) of ~~the AS~~PA, as amended by CICA, states as Congressional defense procurement policy:

> (c) Further, it is the policy of Congress that a fair proportion of the purchases and contracts entered into under this chapter be placed with small business concerns.

This same Congressional Policy is set forth in Section 302 of the FPASA.

Sections 303(a) of the FPASA and 2304(a)(1) of ~~the ASPA~~ 10 USC, as amended by sec 2711 CICA, require agencies to obtain "full and open" competition through the use of competitive procedures in conducting a procurement for property or services. As defined in the OFPP Act, as amended by the CICA (41 USC 414), "full and open competition" means that "all responsible sources are permitted to submit sealed bids or competitive proposals in a procurement." However, under CICA and P.L. 98-577, agencies are expressly permitted, in sections 303(b)(2) of the FPASA and 2304(b)(2) of ~~the ASPA~~ 10 USC, to fulfill the requirements relating to small business concerns by using procedures which restrict solicitations to small businesses, so long as all such businesses are allowed to compete. The Conference Report (H.R. 98-361, page 1424) explained that the conferees sought to give more precise recognition to set-aside programs authorized by statute and that, in "recognition" of the Congressional policy of providing assistance to small business, agencies are authorized to limit competition to small business concerns only. Moreover, in defining competitive procedures, Sections 309(b) of the FPASA and 10 USC 2302(2) were further amended by P.L. 98-577, to include:

> Procurements conducted in furtherance of Section 15 of the Small Business Act (15 USC 644), [are considered competitive] as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete;

The question has now been raised regarding the appropriateness of the FAR "rule of two" set-aside procedures in light of Section 16 (Executive Agency Responsibilities) of the OFPP Act, as amended by CICA. The pertinent parts of Section 16 now read:

> Sec. 16. To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> > "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".

Does the language in Section 16(1), which directs agencies to ensure receipt of "a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost ...," require that the provisions of the FAR 19-502.2 be revised accordingly?

It is clear that, by enacting this language, Congress intended agencies to apply a standard of lowest reasonable cost in procurement decisions, and the FAR should be revised accordingly. However, it is not clear that Congress intended that the

"sufficient number" language of the amendment eliminate or prohibit use of the "rule of two" as a threshold test in determining to set-aside a procurement for small business participation.

Under the current FAR procedures and the new FAR procedures which implement the CICA (effective April 1, 1985), the so-called "rule of two" is utilized as the threshold test in determining whether to set-aside procurements for small business. The contracting official must still apply the tests of "contractor responsibility" and "reasonable price" prior to executing a small business set-aside. Further, under the express language of the CICA, the contracting official must utilize competitive procedures among the small businesses.

The amendatory language of Section 16(1) was a conference substitute; the conference report includes a statement that: "This requirement applies to all agency procurements, including those made under set-aside programs." However, there is no reference in the legislative history that Congress intended to eliminate the "rule of two" as a regulatory procedure. In fact, Congress has specifically established a "rule of two" as the initial test for determining set-asides in small purchase procurements in Section 15 of the Small Business Act (15 USC 644(j)). Subsection 221(j) of P.L. 95-507 sets forth the following provisions:

> (j) Small purchase procedures
>
> Each contract for the procurement of goods and services which has an anticipated value of less than $10,000 and which is subject to small purchase procedures shall be reserved exclusively for small business concerns unless the contracting officer is unable to obtain offers from two or more small business concerns that are competitive with market prices and in terms of quality and delivery of the goods or services being purchased. In utilizing small purchase procedures, contracting officers shall, wherever circumstances permit, choose a method of payment which minimizes paperwork and facilitates prompt payment to contractor.

Although CICA directs improvement and simplification of small purchase procedures, the above provision of the Small Business Act has not been changed.

Conclusion

As indicated above, Congress has recognized the use of the "rule of two" in certain circumstances as the threshold test for initiating a set-aside. There are other situations in which the guidance is less clear, such as in the "sufficient number" language of Section 16 of the OFPP Act.

It appears, therefore, that the appropriate action under these circumstances would be to establish regulatory provisions which permit discretion by agencies to make set-aside determinations. Such discretion would not affect set-asides for small purchases under 15 USC 644(j), but would permit agency discretion in determining whether to set-aside after considering all pertinent factors; i.e., the nature of the requirement, the marketplace, ability to obtain the lowest reasonable cost, and the emphasis on carrying out the requirements of the small business statutes.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 11 1985

MEMORANDUM FOR JOSEPH R. WRIGHT

FROM: WILLIAM E. MATHIS Bill

SUBJECT: The "Rule of Two"

During our meeting Monday on the FAR "rule of two" provisions, you requested that I prepare a paper on the policy considerations surrounding the "rule of two" issue and also that we work with Mike Horowitz on the legal analysis of this issue. Attached is a point paper on the "rule of two" policy considerations. Also attached is the memorandum I furnished to Mike Horowitz containing our analysis of this issue. (Mike Horowitz advises me that he is the only OMB source for a legal opinion, therefore, Mr. Coleman's memorandum should be considered as a research paper, not a legal opinion.)

After having studied this issue carefully, I have concluded that the Congress did not intend to specifically legislate on the subject of when to set-aside an acquisition for exclusive participation by small business. However, what the Congress did legislate was an emphasis on the promulgation of regulations which require judgment in promoting full and open competition and the lowest reasonable cost to the Government.

Although the "rule of two," coupled with the other two criteria, is not intended to be used without the exercise of judgment, the perception by some is otherwise. For this reason, some modification of the regulatory language may be necessary to assure that contracting officers use sound judgment involving the adequacy of competition in making set-aside determinations.

Attachment

RULE OF TWO POLICY CONSIDERATIONS

- The "rule of two" is one of three criteria designed to implement set-aside programs under the Small Business Act in furtherance of the requirement that a fair proportion of Government contracts be placed with small business.

- The purpose of small business set-asides is not Federal largess to a certain economic sector. By assisting small business, we are also enlarging the industrial base and increasing competition for Federal contracts.

- The current FAR policy requires the contracting officer to make three determinations before deciding to set-aside an acquisition:

  1. There are at least two small business competitors that will compete (a reasonable expectation).

  2. They are responsible (can produce the quality required by the Government).

  3. Awards will be made at reasonable prices. (A contracting officer is not permitted, under a set-aside or otherwise, to make an award at an unreasonable price.)

- Agency program and technical offices are often distrustful of small business. This attitude is transmitted to contracting officers who must ultimately make the set-aside decision in support of the Small Business Act. Without clear and uniform policy guidance the contracting officers feel considerable pressure from the program offices not to make a set-aside for small business.

- The "rule of two," (properly called the "Rule of Two or More") along with the other two criteria, provides clear and uniform criteria for a contracting officer to use in deciding whether or not to make a set-aside.

- The terms "two or more" and "more than one" define competition for all Federal procurement. Therefore, the FAR provisions are merely stating that small business set-asides must be competitive. Contracting officers are not permitted under the set-aside program to limit the number of competing small businesses. By changing the traditional definition of competition from "two or more" to "sufficient number," there will be in effect a double standard for defining competition - one for small business (which will be nonstandard and imprecise) and another for all other Federal procurement.

- Agency heads are required by P.L. 95-507, to negotiate - with the SBA -annual goals for awards to small business. The establishment and achievement of these goals are carefully scrutinized by the House and Senate Small Business Committees. Set-asides are the principle means of assuring that proper awards will be made to small business in attempting to meet these goals.

- The SBA, the Small Business Committees, and the Agency small business representatives perceive that this change sends a signal to contracting officers that the small business set-aside program has been relaxed. It is emotional because they see it as a threat to the effectiveness of the program. (See attached SBA letter.)

- If it is determined that, as a matter of law, the words of the FAR must be changed to reflect the words in P.L. 98-369, such directive should contain additional guidance which emphasizes that contracting officers are charged with the responsibility to independently determine what constitutes sufficient competition and that two responsible contractors under appropriate circumstances may be sufficient.

Attachment

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 11 1985

MEMORANDUM FOR: WILLIAM MATHIS

FROM: William S. Coleman, Jr.

SUBJECT: Rule of Two

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Analysis

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The FAR provision constitutes the executive branch implementation of Section 15 of the Small Business Act (15 USC 644), which requires that contracting agencies ensure that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns.

Congress' intent, as expressed in these provisions of the Small Business Act, is confirmed in recent amendments to the Federal Property and Administrative Services Act (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Procurement Policy Act (OFPP), as set forth in the CICA and the Small Business and Federal Procurement Competition Enhancement Act of 1984 (P.L. 98-577).

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U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

JAN 11 1985

Mr. William Mathis
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Washington, D. C. 20503

Dear Mr. Mathis:

This is in response to your request that we provide comments on the impact of modifying the so-called "Rule of Two" found in Federal Acquisition Regulation (FAR), Section 19.502. As we understand it, the proposed modification would change the FAR language to require that the Contracting Officer determine that there is a reasonable expectation that offers will be obtained from a sufficient number of small businesses at the lowest reasonable cost to ensure free and open competition (emphasis supplied).

This change is thought by some to be indicated because they have concluded that the existing FAR 19.502 is inconsistent with the provisions of Section 2732(b)(2) of the Competition in Contracting Act. At the outset, this Agency takes the position that no such inconsistency exists. We believe that changing or eliminating the guidance to Contracting Officers by the Rule of Two about how to make the threshold decision to set a procurement aside is not dictated by the Competition in Contracting Act.

The proposed change would abolish the rule and result in no guidance at all to Contracting Officers. Based on our experience, we believe that the impact on the set-aside program would be devastating.

Both Congress and the Office of Management and Budget have recently concluded in the spare parts program that once a product or service becomes the exclusive domain of large business as a result of limiting sources and/or competition, the price increases on certain items are unacceptable. Thus, as a matter of public policy, Congress and OMB acted to increase small business participation in the provision of spare parts. By setting certain spare parts procurements aside for small businesses, uncontested savings of hundreds of millions of dollars have resulted. Those savings would be lost if the number of set-asides was reduced because of elimination of the rule.

It is an established fact that once a procurement is set aside, competition is increased. The Department of Defense averages 10 small businesses bidding on set-asides, the National

Aeronautics and Space Administration 12, and the General Services Administration more than 10. Unrestricted procurements do not bring this number of bids in most instances.

The Rule of Two effectively came into being in FY 1981. It was promulgated in July 1979, but because of distribution delays and changes did not have significant impact in FY 1980. Our analysis of DOD data reflects that increases attributable to the impact of the rule were 35.8 percent in FY 1981; 19.0 percent in FY 1982; 4.4 percent in FY 1983; and are projected at over 6 percent in FY 1984. These data reflect percentage increases in the small business share of the DOD procurement dollars in the set-aside program and are adjusted so that small purchase set-asides are not included.

Since the civilian agencies have only been subject to the rule since April 1984, and final FY 1984 data are not available from the Federal Procurement Data Center, we have made no attempt to analyze projected data.

We must conclude that since the above data reflect the greatest increase in small business participation in the program's history in DOD, elimination of the rule will result in substantially reduced set-asides.

This is not to say that the program is free of problems. We believe, however, that the effect of having no guidance to Contracting Officers as to when to set a procurement aside will adversely affect small business participation in Federal procurement programs. This will have the attendant effect of limiting growth in the industrial base encouraged in the Small Business Act and Public Law 98-577. Further, the return to the Treasury in taxes from small business is generally considered greater because many small businesses pay taxes as individuals without the more favorable corporate rates.

When using numbers to describe competition, the phrase "two or more" as found in Section 19.502 of the FAR is almost universally used. This can be misleading because in most instances there are far more than two small businesses interested in a given procurement. We think that the proposed language is too vague and that using another number would have little or no effect.

There are approaches which would provide a contracting officer flexibility in ensuring free and open competition while preserving the Rule of Two. We think that these alternatives should be examined in establishing policy concerning set-asides. We further believe other independent factors may operate with

the Rule of Two to produce undesired results in certain industries. We suggest an examination of those factors and their effect before eliminating the rule.

We would be happy to participate with the Office of Federal Procurement Policy and the two Councils in reviewing comments on the Rule of Two and working to achieve the goals of increased industrial capacity, free and open competition, and savings to the taxpayers.

Yours truly,

for Rene Castillo Jr.

James C. Sanders
Administrator

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 15 1985

MEMORANDUM FOR RECORD

Bill Mathis and I, along with Gordon Wheeler (LA), met on Tuesday, January 8, 1985, with Bill Jones, Staff Director, House Government Operations Committee and Jim Lewin, Committee Staff.

Among the matters discussed were: (1) OFPP plan to test raising socio-economic thresholds to the small purchase ceiling; (2) the recent OFPP report on procurement of services; and (3) the "Rule of Two or More," (4) Grace Commission recommendations.

Items (1) and (4): Jones' reaction to the OFPP test on raising thresholds was one of great caution. Noting that this coincided with a Grace Commission recommendation he said "it is one thing for a Commission to make such a recommendation in a report and another to live with the political realities of getting it done." He also advised that OFPP (or OMB) would be responsible for going to all the substantive Hill committees and getting their approval of raising the socio-economic thresholds on a test basis. He said his Committee (and Chairman) would not consider any OFPP proposals to raise thresholds on test basis without prior approval of affected committees.

At this point, Bill Jones strongly criticized the Grace Commission recommendations, stating they were just policy judgments, rather than recommendations to improve efficiency. He said any OFPP proposals "tied to the Grace Commission recommendations" would not be looked on favorably.

Item 2: Jim Lewin was very critical of the recent OFPP report on procurement of services.

Item 4: Jones raised the "Rule of Two or More" issue. He and Lewin repeated the argument that CICA had negated the Rule. We did not respond to this statement. However, we did point out to them that: The agencies were compelled by P.L. 95-507 to establish annual goals for awards to small and small disadvantaged businesses; (2) the set-aside program was the only way to preferentially assure that awards would go to small business; (3) that the concentration of the program on those industries where small businesses abound was necessary because set-asides were obviously not possible in procurement of missiles, aircraft, weapons systems, etc. Jones acknowledged this but insisted it was "unfair" to have certain areas where all Government business was under the set-aside program.

Owen Birnbaum
Deputy Associate Administrator
for Policy Development

ECUTIVE OFFICE OF THE PRESID
OFFICE OF MANAGEMENT AND BUDGE
WASHINGTON, D.C. 20503

RECEIV
85 JAN 15 3 : 3

MEMORANDUM January 15, 1985

TO: Joe Wright

FROM: Mike Horowitz MH

RE: Rule of Two

1. This opinion concerns the legality of the "rule of two" now applied in set-aside decisions under new FAR 19.502-2.

2. Following my examination of the statute and its legislative history, I fully concur in the Brooks-Horton-Cohen-Levin view of the law. It is, accordingly, my opinion that the rule of two is inconsistent with the new standard enacted by the Competition in Contracting Act of 1984 (CICA), Title VII of the Deficit Reduction Act of 1984, P.L. 98-369. Consequently, I propose revising the offending FAR, not only to incorporate the "sufficient number of bids" standard established by CICA, but also, equally importantly, to ensure that these bids will result in awards at the "lowest reasonable cost," the second prong of the new CICA standard.

3. The Small Business Act (15 USC 644) authorizes the use of set-aside procurement for small businesses when it is determined to be (1) in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) in the interest of war or national defense programs, (3) in the interest of assuring that "a fair proportion of total purchases and contracts for property and services for the Government are placed in small business concerns" or (4) in assuring that "a fair proportion of the total sales of Government property be made to small business concerns."

4. FAR 19.502-2 was included in the comprehensive revisions to the FARs published in September, 1983, effective on April 1, 1984. Another set of revisions, purportedly incorporating the changes required by CICA, was published for comment on October 1, 1984 and submitted to the printer on December 1, 1984.

5. FAR 19.502-2 (which is not modified by the latest revision) implements Section 15 of the Small Business Act by providing that an individual acquisition or class of acquisitions "shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be

made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists." (Emphasis added.) Partial set-asides are also made subject to this standard.

6. On March 14, 1984 Congressman Brooks wrote to the Director complaining that the "rule of two" set-aside provisions in the final FAR 19.502-2 rule (1) were not included in the version that went out for public comment and (2) violate the law.

7. Don Sowle's May 30, 1984 response to Brooks understandably focused almost exclusively on whether the FAR properly implements the Small Business Act, contending that the "issue is not the method of determining the existence of adequate competition among small businesses" but, rather, the propriety of set-asides, which he felt had been resolved by Congress in the Small Business Act in favor of "non-procurement related public policies (socio-economic goals)."

8. CICA, Title VII of the Deficit Reduction Act of 1984, contains several provisions relating to competition in procurement, amending both the Federal Property and Administrative Services Act of 1949 (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Property Procurement Act (OFPPA). The CICA amendment to Section 16 of the OFPPA was a conference committee substitute. It mandates that executive agencies increase the use of "full and open competition" in procurement by "establishing ... procedures ... that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.) The conference report explains that this language is applicable when agencies are "using competitive procedures" and that the requirement "applies to all agency procurements, including those made under set-aside programs." (Note that old FPR 1-1.706-5 permitted total set asides under a "sufficient number" standard.)

9. It is my opinion that the CICA amendment to Section 16 of the OFPPA requires that the "rule of two" in the FAR set-aside regulations be replaced by a "sufficient number of bids" standard and that the "at reasonable prices" standard be changed to CICA's "lowest reasonable cost" test. In some circumstances full and open competition (the lowest reasonable cost) may be assumed on the basis of only two bids. However, the crucial test is competitiveness, not, as is the case with a rule of two, the lowest possible number.

10. Both OMB and OFPP have authority to ensure that the CICA changes are implemented in the revised FARs. Section 6(a) of the OFPPA vests in the Administrator of OFPP the "overall direction of procurement policy and leadership in the development of procurement systems of executive agencies" and, as a result of

the 1983 amendments restoring OFPP's regulatory authority, is authorized to "prescribe Government-wide procurement policies which shall be implemented in the single system of Government-wide procurement regulations...." Section 405 of Title 41, U.S. Code, gives the Administrator the authority, and directs him, "to promulgate a single, simplified, uniform Federal procurement regulation and to establish procedures for insuring compliance with such provisions by all Federal agencies." In addition, Section 6(b) permits the Administrator to prescribe Government-wide regulations when DoD, NASA and GSA are "unable to agree on or fail to issue Government-wide regulations ... in a timely manner." Finally, and most importantly, in Section 6(f) of the OFPPA, the Director of OMB is given ultimate oversight authority over agency procurement regulations, being empowered to "deny the promulgation of or rescind any Government-wide regulation or final rule or regulation of any executive agency relating to procurement if the Administrator determines that such rule or regulation is inconsistent with the policies set forth in section 401 of [the Act] or any policies, regulations, or procedures issued pursuant to [Section 6(a) of the Act]." The section 401 policies include "promoting full and open competition" and "establishing ... procedures ... which will provide ... property and services ... at the lowest reasonable cost." Section 6(a) of the Act, described above, vests in the Administrator the overall direction of procurement policy. In short, OFPP has regulatory authority in the event, as with the rule of two, of agency disagreement, as well as when a regulation is inconsistent with OFPP's policies -- such as that of full and fair competition, cited both in Section 401 and in the CICA amendment to Section 16.

11. I am informed that many of the changes which the GAO/Brooks letter found to be required by CICA have not been made and will not appear in the FAR revision which is now at the printers - purportedly because the recommended changes were not received in time to permit the FAR regulations to be in place and ready for implementation on April 1, 1984, the effective date of CICA.

12. In light of the above, I am directing my staff to work with OFPP to develop revisions, not only to the "rule of two" FAR provisions, but also, as necessary to properly implement CICA, to the other FAR provisions discussed in the Brooks/GAO letter. I am asking Diane Weinstein of my staff to come up with a proposed revision to FAR 19-502-2 within the next 10 days.

cc: Arlene Triplett
    Bill Mathis

FEB 27 1985

Honorable James C. Sanders
Administrator
Small Business Administration
Washington, DC 20416

Dear Mr. Sanders:

Thank you for your letter of February 8, 1985, concerning the "Rule of Two or More" and its importance to the small business set-aside program.

I will make sure that you receive notice when this subject is put on the agenda of the Cabinet Council on Management and Administration so you may attend the meeting and state your views.

Sincerely,

WILLIAM

William E. Mathis
Acting Administrator

cc:
OFPP File/Chron/Reading
Correspondence Unit
Mr. Birnbaum
Mr. Mathis

OFPP:OBirnbaum:mbd 2/27/85 OMB Control #: 20078

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

FEB15 : 13

FEB

ICE UNIT

Mr. Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D. C. 20503

Dear ~~Mr. Wright:~~ Joe:

It has been brought to my attention in conversations with Department of Defense and Office of Federal Procurement Policy officials that the subject of the so-called "rule of two or more" as it is presently expressed in the Federal Acquisition Regulations may be an agenda item for a forthcoming Cabinet Council on Management and Administration meeting. As you may know, we consider that rule essential to the continued success of the small business set-aside program administered by this Agency.

In the event the Council does take up this issue, I should like to be present at the meeting to express the views of this Agency that the continuation of the rule, as it is presently set forth, is not in conflict with existing statute and in fact is sound public policy.

Your continued cooperation in this matter is appreciated.

Yours truly,

Jim

James C. Sanders
Administrator

MAR 6 1985

MEMORANDUM FOR ARLENE TRIPLETT

FROM: Bill Mathis WILLIAM B. MATHIS

SUBJECT: Rule of Two

Attached is some proposed language to effect the compromise you requested. I believe the language draws the necessary distinction between initiating a set-aside procurement action and the important Competition in Contracting Act language requiring receipt of a sufficient number of competitive bids or proposals and award at the lowest reasonable cost. I hope this compromise will be acceptable to the procuring agencies and satisfy Mike Horowitz's legal concerns.

19.502-2 Total set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists (but see 19.502-3 as to partial set-asides). Notwithstanding the foregoing, contracting officers are cautioned that the Office of Federal Procurement Policy Act, as amended by the Competition in Contracting Act of 1984, requires that under set-asides there be received a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured.

Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

Underlined: New Language

Mr. Coleman

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

March 18, 1985

MEMORANDUM FOR THE RECORD

On Monday, March 4, 1985, the undersigned met with Joe Wright, Arlene Triplett, Mike Horowitz, and Diane Weinstein on the Rule of Two. Shortly after the meeting began it was apparent that the topic of conversation (about which we had not been fully informed prior to the meeting) was Mike Horowitz' memorandum to Joe Wright of January 15, 1985 in which he concluded that: "The CICA amendment to Section 16 of the OFPP Act requires that the 'rule of two' in the FAR set-aside regulations be replaced by a 'sufficient number of bids' standard and that the 'reasonable price' standard be changed to CICA's 'lowest reasonable cost' text."

Mr. Horowitz seemed particularly disturbed that OFPP was questioning his legal judgment and was not moving promptly to have the necessary FAR changes made to replace the "at least two" language with the "sufficient number" language he deemed required by CICA. The OFPP representatives then called to Mr. Horowitz' attention the following: 1) The language he relied on in new Section 16(1) of the OFPP Act (inserted by CICA) had to do with the receipt of bid and proposals once an invitation had been issued; 2) CICA itself stated that the sealed bids procedure is to "be used if there is a reasonable expectation of receiving more than one sealed bid" (emphasis added); and 3) both CICA and PL 98-577 specifically recognize small business set-asides as a competitive procedure provided only all eligible small business sources may bid. It was also pointed out to Mr. Horowitz that Congress, in Section 221(j) of PL 95-507, recognized the adequacy for purposes of competition of "at least two" small businesses for a set-aside of small purchases.

After a short while, Joe Wright suggested that we leave the legal question and that OFPP explain to him why, on a policy basis, the rule of two was necessary. Owen Birnbaum explained that the rule had been instituted by DOD in 1979 because its experience had shown that contracting officers were using (or misusing) the imprecise "sufficient number test" to avoid making set-asides. (It was also pointed out that DOD was not particularly known as a friend of small business.) DOD's

experience had shown that the rule was necessary to have an effective set-aside program and that the set- aside program was the "heart" of the small business procurement program. Finally, it was noted that the agencies had annual goals imposed upon them by virtue of Section 221 of PL 95-507 and that the set-aside program was a critical factor in meeting these goals.

Mr. Horowitz seemed to become increasingly irritated with the explanations offered by the OFPP representatives. In the course of his criticisms of the small business and small disadvantaged business programs, he constantly referred to the small business and small disadvantaged business officials as "small business junkies," "OSDBU junkies," and "minority business junkies". It was explained to him that these officials to whom he referred as "junkies" were persons holding positions established by statute (PL 95-507). This made little or no impression upon him, and at one point he appealed to the OFPP staff to "help him get rid of these people" (the OSDBU officials). Mr. Horowitz also made reference to the DOD OSDBU official as "that woman who is giving Will Taft a bad time".

Mike Horowitz complained to Joe Wright about the Federal Government's small business and small disadvantaged business programs and made disparaging remarks about the SADBU officials in government agencies. On at least one occasion, Mr. Horowitz pronounced the acronyms SADBU and OSDBU in a highly derisive manner, which one could interpret as an attempt to effect a black accent.

Toward the end of the meeting, Joe Wright stated that he owed a return call to Mr. Taft who had called earlier to request no final action be taken on the rule of two until DOD had made its case on behalf of the rule. Mention was also made of having this matter go to the Cabinet Council on Management and Administration, but this discussion seemed inconclusive.

The meeting ended with Mike Horowitz' request to Joe Wright that "we political people" (meaning Joe Wright, Mike Horowitz and Arlene Triplett) "meet alone to decide this matter."

William E. Mathis

Owen Birnbaum

William S. Coleman Jr.

APR 3 1985

MEMORANDUM THRU: ARLENE TRIPLETT

TO: JOSEPH WRIGHT

WILLIAM E. MATHIS

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two

By its Federal Register notice of October 12, 1984, OFPP solicited views on the "Rule of At Least Two" as set forth in Part 19 of the Federal Acquisition Regulation (FAR). The October 1984 publication resulted from criticism that this provision in the FAR had not been publicized and available for public comment in the FAR process.

OFPP has now completed its analysis of comments received in response to the Federal Register notice and needs your advice and guidance on developing OMB's position on this matter. In response to the notice we received 199 comments, of which seventy-two (72) supported the rule and 127 opposed it.*

a. 72 comments supporting the rule: Of the private sector comments almost all were from small and minority businesses. Generally, these comments noted that prior to the rule contracting officers could, and did, avoid making set-asides under the subjective "sufficient number" standard. Further, that the set-aside program was a critical element in the Government's small business program and that the survival of small and minority businesses was at stake.

b. 127 comments opposing the rule: Of the private sector comments almost all were from what appeared to be large companies or trade associations.

   Many architect/engineer or construction companies commented in opposition to the rule. Many comments combined specific opposition to the rule with general criticism of the small business set-aside program itself.

Among the arguments contained in the "opposing" comments were that the rule is: Inconsistent with the new standard of "sufficient number" set forth in the 1984 Competition in Contracting Act (CICA); does not afford the contracting officer sufficient discretion in initiating a set-aside; has led, in certain industries, to

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*These figures are necessarily approximations. In some instances, numerous "offices" or "divisions" of a parent company sent in separate letters, largely identical. Some letters both "supported" and "criticized" the rule. Some criticized the set-aside program rather than the rule. All of this made precise "counting" very difficult. On balance, however, it is fair to say that 72 comments supported the rule and 127 opposed it.

OFPP File/Chron/Reading
Mr. Birnbaum
Mr. Mathis

OFPP:OBirnbaum:mbd 4/2/85 2

disproportionate shares going to small business, etc. As noted, some of the comments were directed not against the rule but related to shortcomings in the actual operation of the set-aside program itself.

Because several of these arguments appeared to have merit, we met with Frank Swain and other SBA officials. We advised SBA of our concern that a small company could apparently receive an award under a set-aside and then subcontract an inordinate percentage to a large business. Swain acknowledged SBA has no procedure in place to prevent this and promised prompt action. We also recommended that SBA investigate the possibility of "tiering" set-asides in A-E (construction) and other controversial areas. (For example, on a proposed procurement of, say, under $150,000 only firms with gross receipts of under $ x million could bid; on a procurement of $300,000 only firms with receipts of under $ y million could bid; and on procurements over a certain amount there would be no set-aside). Finally, we noted the anomaly of a small or a minority firm receiving a contract in a value greater than its size standard. SBA (Swain) will report back to us on these issues by the end of the month.

Secretary Taft, we understand, has a continuing and abiding interest in this matter. DOD (Taft) says it likes the rule and needs it.

The FAR staff has issued its interim implementation of CICA. The implementation does not address the issue of the rule.

The OFPP recommendation is to maintain the status quo and retain the rule. Our recommendation is based on the following: (1) The rule is a critical element in the small business set-aside program which, in turn, is a mainstay of the entire small business program. (2) The small business community, as well as the minority business community, is solidly behind the rule. (3) The FAR implementation is consistent with the CICA requirement for agency procedures to assure receipt of a "sufficient number of sealed bids or competitive proposals" with awards at the "lowest reasonable cost." (The set-aside program, incidentally, was firmly endorsed by Mr. Stockman in his recent testimony before the Senate Small Business Committee. Also, a vigorous small business community helps to keep large business more competitive.) (4) Almost all the agencies (not just DOD) support the rule. DOD formally instituted the rule in 1979 and Navy has used it for more than 20 years. (5) Deficiencies and shortcomings of the set-aside program, itself, can be remedied along the lines of our recent conversation with Swain, et. al. at SBA.

TO OFPP:

☐	☐	☐	☐
See me	Keep the FAR as is	Use compromise language in my memo to Arlene Triplett of March 6, 1985	Eliminate rule on the basis of Mike Howowitz's legal memorandum of Jan. 15, 1985

cc:
Mike Horowitz

MAR 6 1985

MEMORANDUM FOR ARLENE TRIPLETT

FROM: Bill Mathis WILLIAM E. [illegible]

SUBJECT: Rule of Two

Attached is some proposed language to effect the compromise you requested. I believe the language draws the necessary distinction between initiating a set-aside procurement action and the important Competition in Contracting Act language requiring receipt of a sufficient number of competitive bids or proposals and award at the lowest reasonable cost. I hope this compromise will be acceptable to the procuring agencies and satisfy Mike Horowitz's legal concerns.

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Although past acquisition history of the item or similar items is always important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In making R&D small business set-asides, there must also be a reasonable expectation of obtaining from small business the best scientific and technological sources consistent with the demands of the proposed acquisition for the best mix of cost, performances, and schedules.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

cc. Mathis -
cc: Birkhofer

RECEIVED OFPP
85 APR 25 P2:24

MEMORANDUM

April 23, 1985

TO: Joe Wright

FROM: Michael Horowitz MH

SUBJECT: Rule of Two

Pleased as I am that Bill Mathis and Bill Birkhofer have worked out congenial solutions (e.g., tiering, etc.) to the ACEC's special concerns, I must reiterate that merely adding some hortatory "cautionary" language -- effectively as an after-thought -- to the FAR rule of two provision does not, in my opinion, comply with the intent of the CICA requirement, articulated in the Brooks letter, that the Rule of Two be abolished in its entirety.

Furthermore, I have serious doubts that SBA approval to tiering small business set asides for selected "controversial areas" can be secured. Absent such approval, OFPP's authority unilaterally to institute such tiering through the FAR system is highly questionable.

The problem with the Rule of Two is not that it hurts A & E firms -- or any specific industry -- but that it is mechanically applied, without regard to whether a set aside will result in a sufficient number of bids to assure awards at the "lowest reasonable cost," as CICA requires. The problem of mechanical application of the rule of two is compounded by the FAR's requirement that only decisions not to set aside a procurement be documented.

Therefore, once again, it is my legal opinion that the Rule of Two must be replaced with the new CICA language. If an after-thought is necessary, I am willing to consider adding a statement acknowledging that "two" may in certain circumstances be a "sufficient number," but that any set aside based on such a small number must be specifically documented.

✓ cc: Arlene Triplett

cc:
OFPP File/Chron/Reading
Ms. Triplett
Mr. Mathis
Mr. Birnbaum

OFPP:OBirnbaum:mbd 4/17/85 APR 18 1985

MEMORANDUM THRU: ARLENE TRIPLETT

TO: JOSEPH WRIGHT

WILLIAM E. MATHIS

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two

After our meeting last Friday I moved to implement your suggestions on amending FAR 19.505-2, Total Set-Asides Provision (TSAP) re the "Rule of At Least Two."

First, Owen Birnbaum and I met with a staff member of the Senate Small Business Committee authorized to speak for Bob Dotchin, the Staff Director. The representative, Bill Montalto, was receptive to our suggestions that: (1) A&E procurements be tiered to "marry" the size of competing A&E firms with the size of the procurement (see our memo to you of April 3, 1985); (2) Prevent excessive subcontracting by small firms receiving awards under small business set-asides; (3) Carefully examine the anomaly of awards to a small or minority company in an amount greater than its size standard. He was also impressed with our plans to revise the FAR, discussed in detail below, to stress more selective set-aside procedures.

Second, we met with Bill Birkhofer, Associate Director, of the American Consulting Engineers Council (ACEC). He, also, was receptive to the proposals set forth in the preceding paragraph. We discussed with Birkhofer the TSAP ("Rule of at Least Two") in great detail. We agreed in principle, and even in some detail, on an amendment to the TSAP (FAR 19.502.2) to caution contracting officers that they: (1) should not apply the set-aside procedures mechanically or unthinkingly; (2) should consider the Government's need for high-quality items, particularly in high-tech areas; and (3) must follow the CICA requirement for receipt of a "sufficient number" of bids from responsible sources to fulfill the Government's requirements at the lowest reasonable cost.

Birkhofer admitted to us, quite candidly but not for general dissemination, that the "Rule of at Least Two" was not his problem but that he used it to "get the Government's attention." His problem, frankly stated, is SBA's unreasonably high size standard and his frustration since 1981 in getting the standard lowered. In my opinion, the standard of $7.5 million of sales averaged over a three year period is too high and should probably be set at $2,000,000. I will be pleased to demonstrate the basis for that judgment.

I am not happy at the slow pace at which SBA is moving on the matters we discussed with Frank Swain, Don Young, et.al. almost a month ago. I prefer to move in concert with them but am prepared to proceed without them, if necessary.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

APR 18 1985

MEMORANDUM THRU: ARLENE TRIPLETT

TO: JOSEPH WRIGHT

Bill

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two

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Second, we met with Bill Birkhofer, Associate Director, of the American Consulting Engineers Council (ACEC). He, also, was receptive to the proposals set forth in the preceding paragraph. We discussed with Birkhofer the TSAP ("Rule of at Least Two") in great detail. We agreed in principle, and even in some detail, on an amendment to the TSAP (FAR 19.502.2) to caution contracting officers that they: (1) should not apply the set-aside procedures mechanically or unthinkingly; (2) should consider the Government's need for high-quality items, particularly in high-tech areas; and (3) must follow the CICA requirement for receipt of a "sufficient number" of bids from responsible sources to fulfill the Government's requirements at the lowest reasonable cost.

Birkhofer admitted to us, quite candidly but not for general dissemination, that the "Rule of at Least Two" was not his problem but that he used it to "get the Government's attention." His problem, frankly stated, is SBA's unreasonably high size standard and his frustration since 1981 in getting the standard lowered. In my opinion, the standard of $7.5 million of sales averaged over a three year period is too high and should probably be set at $2,000,000. I will be pleased to demonstrate the basis for that judgment.

I am not happy at the slow pace at which SBA is moving on the matters we discussed with Frank Swain, Don Young, et.al. almost a month ago. I prefer to move in concert with them but am prepared to proceed without them, if necessary.

MEMORANDUM TO JOSEPH WRIGHT

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two

By its Federal Register notice of October 12, 1984, [redacted] OFPP solicited views on the "Rule of At Least Two" as set forth in Part 19 of the Federal Acquisition Regulation (FAR). The October 1984 publication resulted from criticism that this provision in the FAR had not been publicized and available for public comment in the FAR process.

OFPP has now completed its analysis of comments received in response to the Federal Register notice and needs your advice and guidance on developing OMB's position on this matter. In response to the notice we received 199 comments, of which seventy-two (72) supported the rule and 127 opposed it.*

a. 72 comments supporting the rule: Of the private sector comments almost all were from small and minority businesses. Generally, these comments noted that prior to the rule contracting officers could, and did, avoid making set-asides under the subjective "sufficient number" standard. Further, that the set-aside program was a critical element in the Government's small business program and that the survival of small and minority was at stake.

b. 127 comments opposing the rule: Of the private sector comments almost all were from what appeared to be large companies or trade associations.

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*These figures are necessarily approximations. In some instances, numerous "offices" or "divisions" of a parent company sent in separate letters, largely identical. Some letters both "supported" and "criticized" the rule. Some criticized the set-aside program rather than the rule. All of this made precise "counting" very difficult. On balance, however, it is fair to say that 72 comments supported the rule and 127 opposed it.

Many architect/engineer or construction companies commented in opposition to the rule. Many comments combined specific opposition to the rule with general criticism of the small business set-aside program itself.

Among the arguments contained in the "opposing" comments were that the rule is: Inconsistent with the new standard of "sufficient number" set forth in the 1984 Competition in Contracting Act (CICA); does not afford the contracting officer sufficient discretion in initiating a set-aside; has led, in certain industries, to disproportionate shares going to small business, etc. As noted, some of the comments were directed not against the rule but related to shortcomings in the actual operation of the set-aside program itself.

Because several of these arguments appeared to have merit, we met with Frank Swain and other SBA officials. We advised SBA of our concern that a small company could apparently receive an award under a set-aside and then subcontract an inordinate percentage to a large business. Swain acknowledged SBA has no procedure in place to prevent this and promised prompt action. We also recommended that SBA investigate the possibility of "tiering" set-asides in A-E (construction) and other controversial areas. (For example, on a proposed procurement of, say, under $150,000 only firms with gross receipts of under $ x million could bid; on a procurement of $300,000 only firms with receipts of under $ y million could bid; and on procurements over a certain amount there would be no set-aside). Finally, we noted the anomaly of a small or a minority firm receiving a contract in a value greater than its size standard. SBA (Swain) will report back to us on these issues by the end of the month.

Secretary Taft, we understand, has a continuing and abiding interest in this matter. DOD (Taft) says it likes the rule and needs it.

The FAR staff has issued its interim implementation of CICA. The implementation does not address the issue of the rule.

The OFPP recommendation is maintain the status quo and retain the rule. Our recommendation is based on the following: (1) The rule is a critical element in the small business set-aside program which, in turn, is a mainstay of the entire small business program. (2) The minority business community, as well as the small business community, is solidly behind the rule. (3) The FAR implementation is consistent with the CICA requirement for agency procedures to assure receipt of a "sufficient number of sealed bids or competitive proposals" with awards at the "lowest reasonable cost." (The set-aside program, incidentally, was firmly endorsed by Mr. Stockman in his recent testimony before the Senate Small Business Committee. Also, a vigorous small business community helps to keep large business more competitive.) (4) Almost all the agencies (not just DOD) support the rule. DOD formally instituted the rule in 1979 and Navy has used it for more than 20 years. (5) Deficiencies and shortcomings of the set-aside program, itself, can be remedied along the lines of our recent conversation with Swain, et. al. at SBA.

TO OFPP:

☐	☐	☐	☐
See me	Keep the FAR as is	Use compromise language in my memo to Arlene Triplett of March 6, 1985	Eliminate rule on basis of Mike Howowitz's legal memorandum of Jan. 15, 1985

MAY 22 1985

MEMORANDUM TO: Arlene Triplett

FROM: Bill Mathis WILLIAM E. MATHIS

SUBJECT: Rule of At Least Two

Here are the answers to Joe's questions re two statements in my May 3rd memo.

Statement: "In addition to being arbitrarily discriminatory it (Mike Horowitz's proposal) might well diminish competition from small businesses in the highly publicized area of procurement of spare and replacement parts."

Answer to "Why?" If the fixed number of five (5) were established (per Mike's suggestion) and only 3 or 4 responsible small firms were available to compete for procurement of spare parts, no set-aside would be made. Thus, competition from small businesses could be diminished. Often, small businesses elect not to compete with large businesses, particularly when the large business is the prime source for the system. Incidentally, it was the National Tooling and Machining Association (NTMA), a predominantly small business trade association, which most actively opposed the Pentagon's program for procurement of spare parts and which continues to press for changes and greater small business participation, claiming lower prices for the spares from small business.

Statement: "Whenever fewer firms were available it would present problems of administration as well as contract award."

Answer to "Why?" Every time one increases anything from two to five, it can be expected that problems of administration will tend to increase. For example, arguments as to whether a source is a "small business," or competent or responsible, or whatever, between the contracting officer, the sources, the S.B.A., the user, etc. are more likely to occur. Most of the procedural steps in Part 19 of the FAR could be cited as potential administrative complications.

It seems easier to determine one has at least two sources than at least five. Suppose, for instance, the contracting officer only knows of four small businesses that can do the job. Does he set aside or not? Under the existing rule he knows he will. But under Mike's rule he has to find another before you initiate a set aside.

✓ cc:
OFPP Official File/Chron/Reading
Mr. Mathis
Mr. Keegan
Mr. Birnbaum

OFPP:OBirnbaum:ran:5/21/85

Cpy: Birnbaum V

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

TO: Mathis

FROM: Associate Director for Management at

Please give me a response for JRW's "whys".

RECEIVED OFPP
85 MAY 14 A11 : 23

Rcvd: OB
5/13, 14

5/13

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAY 3 1985

AT — What do you think?

MEMORANDUM FOR JOE WRIGHT

FROM: BILL MATHIS Bill

SUBJECT: Rule of At Least Two

At the conclusion of our final meeting on Thursday, April 25, you asked that I prepare a memorandum of the differences between the Rule of At Least Two (Total Set-Aside Procedures or TSAP) and Mike Horowitz's proposal to select a number higher than two. As I understand Mike's proposal of a "greater number than two" it envisions, also, a mechanism for reducing or increasing the fixed number.

First, the Rule of At Least Two: DOD adopted the Rule in 1979 after reviewing the Navy's extensive experience with it. It did so precisely because it embodied a fixed, minimum number (two). As explained in my earlier memorandum, DOD's pre-1979 experience was: (1) contracting officers somehow never found a "sufficient number" of small firms necessary to institute a set-aside; (2) "two" was, obviously, a quantifiable number which historically had been (and still is) the minimum number constituting competition.*

As Owen Birnbaum and I explained last Thursday, it would seem difficult (if not impossible) to explain how "more than one" is sufficient competition for an expenditure of $26 million dollars with a large firm, but not sufficient for a contract with a small firm for $26,000. As you know, the CICA defines competition as "receiving more than one sealed bid". However, during FY 1984, approximately $110 billion out of a total of $182.8 billion was expended on contracts where only one proposal was received.

Mike Horowitz's latest proposal for a higher fixed number (say, five) would establish a different, more stringent standard for procurement from small business than from large business. In addition to being arbitrarily discriminatory against small businesses it might well diminish competition from small businesses in the highly publicized area of procurement of spare and replacement parts. Mike's system could work well only where five or more small firms were clearly available. Whenever fewer firms were available it would present problems of administration as well as contract award. In short, the concept proposed creates a wholly new world of what constitutes competition and applies it only to small business - an impolitic and probably indefensible result.

Why?

Why?

~~Why not~~
But this is
for
purposes of
set-asides
not
procurement

1-)

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* Section 2711(a)(1) of the 1984 CICA amends the law to state that "In determining the competitive procedures appropriate under the circumstance, an executive agency shall solicit sealed bids if . . . there is a reasonable expectation of receiving more than one sealed bid." (Emphasis added.)

Mike Horowitz's argument seems not to recognize the difference between the contracting officer's decision to initiate a set-aside and the CICA requirement that agency heads increase the use of free and open competition to insure receipt of a "sufficient number" of proposals from responsible sources at the lowest reasonable cost. The former decision is simply a device to institute a small business set-aside (authorized by the Small Business Act and, again, specifically as a competitive procedure in both CICA and the subsequent P.L. 98-577) based on the expected availability of at least two small firms. The latter criterion is merely a restatement - albeit a firm one - of the long-standing requirement that agencies and contracting officers receive a sufficient number of proposals to ensure that award will be made at the lowest reasonable cost. Indeed, it has always been required that a contracting officer may not make an award if the lowest price is not reasonable.

If any procedure such as Mike's is adopted (and I strongly counsel against it), I recommend that the contracting officer decide upon, announce, and record the quantified minimum number well in advance of proceeding with the procurement. I should note that such a procedure would greatly complicate the procurement process with the probable result of considerably few set-asides for small business, including those for spare parts. I fully expect DOD will oppose the idea but you can mention it to Secretary Taft when you discuss the TSAP with him.

While we do not recommend it, a "sufficient number" standard for initiating a set-aside would be preferable to setting a specific number greater than two because it does not have the "dual standard" problem. We would, however, under the "sufficient number" standard be again confronted with the problem DOD solved in 1979 when it adopted the "Rule of at Least Two".

Finally, I must add, in terms of the present deserved stress on obtaining competition, that small business set-asides are an exemplary form of procurement. As NASA, GSA, and DOD (Secretary Taft) will affirm, far more competition is obtained in this type of procurement than in any other.

cc: Arlene Triplett

JUN 19 1985

MEMORANDUM TO JOE WRIGHT

FROM: BILL MATHIS

SUBJECT: Rule of At Least Two (RLT/TSAP)

Here is the information you requested on Mike's behalf in your May 30 memorandum to me.

In your memo you refer to my estimate of average numbers of bids on DOD, GSA, and NASA small business set-asides (10; 10; and 12, respectively). The basis for my estimate is the SBA Administrator's January 11, 1985 letter to me on the RLT/TSAP, which states in pertinent part:

> "It is an established fact that once a procurement is set aside, competition is increased. The Department of Defense averages 10 small businesses bidding on set-asides, the National Aeronautics and Space Administration 12, and the General Services Administration more than 10. Unrestricted procurements do not bring this number of bids in most instances."

This data was orally confirmed to me several months ago by representatives of the three agencies. Information of this sort is not routinely collected in an automated system. The only indicator involving competition in the automated system is competition vis-à-vis single source. We have not perceived a need to capture data on the number of bids (proposals) received for each procurement. We also note the April 18, 1984, letter to Mr. Stockman of the Deputy Under Secretary of Defense, (Acquisition Management) which states:

> "We would like to note that small business set-asides generally result in more, not less, competition. This increase in competition results because of two factors: There are a much greater number of small business firms than big business firms; secondly, the small business community perceives that when a procurement is set-aside, it, by definition, cannot be a sole source award and that they will be competing against their peers and, therefore, stand a realistic chance of winning the contract."

The general belief that small business set-asides are more competitive than "unrestricted" competition is more than anecdotal. It represents common knowledge and observation of experienced contracting officers, PCR's (procurement center representatives) and knowledgeable procurement officials.

We submit that the precise number of bids received on a small business set-aside (8, 10, or 12, etc.) is relatively unimportant. The important fact is that set-asides are highly competitive and completely consistent with both the letter and spirit of CICA and the Small Business and Federal Procurement Competition Enhancement Act of 1984.

The information requested in the fourth paragraph of your memorandum, for FY 1984, is as follows:

1. Number of acquisitions set aside under FAR 19.502: 3,178,944.*

2. Dollar volume of acquisitions set aside under FAR 19.502: $14.477B.

3. There is no information presently available as to the "average number of bids received once an acquisition is set under section 19.502." OSD advises that it would take a minimum of six months to develop this information, if it can be developed at all. A manual review of the approximately 3.18 million contract actions would involve numerous locations and substantial manpower. OSD has indicated it would be reluctant to expend millions of man-hours on such an effort.

4. This data is not available and would have to be collected during the manual review.

5. The precise number of set-aside determinations withdrawn under FAR 19.506 is not available. It is believed, however, that very few set-asides are withdrawn.

As you know, at our last meeting Mike agreed to contact Stu Evans, Mary Ann Gilleece and Allan Beres to obtain this data. We would be interested to know how our information compares to the data he obtained.

Finally, I am attaching some correspondence that OSD thought might be of interest to OMB/OFPP.

Attachments

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* Of the 3,178,944 set-asides, approximately 5,600,000 were exclusive reservations, under section 221 of P.L. 95-507, of small purchases under $10,000. Such reservations, incidentally, were made under a legislatively mandated Rule of At Least Two.

cc: Arlene Triplett

cc:
OFPP File/Chron/Reading
Mr. Birnbaum
✓Mr. Maraist
Mr. Mathis

OFPP:OBirnbaum:mbd 6/18/85
Retyped:OFPP:OBirnbaum:djw 6/19/85

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

Jan 11/85

JAN 1 1 1985

Mr. William Mathis
Acting Administrator
Office of Federal Procurement Policy
Office of Management and Budget
Washington, D. C. 20503

Dear Mr. Mathis:

This is in response to your request that we provide comments on the impact of modifying the so-called "Rule of Two" found in Federal Acquisition Regulation (FAR), Section 19.502. As we understand it, the proposed modification would change the FAR language to require that the Contracting Officer determine that there is a reasonable expectation that offers will be obtained from a sufficient number of small businesses at the lowest reasonable cost to ensure free and open competition (emphasis supplied).

This change is thought by some to be indicated because they have concluded that the existing FAR 19.502 is inconsistent with the provisions of Section 2732(b)(2) of the Competition in Contracting Act. At the outset, this Agency takes the position that no such inconsistency exists. We believe that changing or eliminating the guidance to Contracting Officers by the Rule of Two about how to make the threshold decision to set a procurement aside is not dictated by the Competition in Contracting Act.

The proposed change would abolish the rule and result in no guidance at all to Contracting Officers. Based on our experience, we believe that the impact on the set-aside program would be devastating.

Both Congress and the Office of Management and Budget have recently concluded in the spare parts program that once a product or service becomes the exclusive domain of large business as a result of limiting sources and/or competition, the price increases on certain items are unacceptable. Thus, as a matter of public policy, Congress and OMB acted to increase small business participation in the provision of spare parts. By setting certain spare parts procurements aside for small businesses, uncontested savings of hundreds of millions of dollars have resulted. Those savings would be lost if the number of set-asides was reduced because of elimination of the rule.

It is an established fact that once a procurement is set aside, competition is increased. The Department of Defense averages 10 small businesses bidding on set-asides, the National

Aeronautics and Space Administration 12, and the General Services Administration more than 10. Unrestricted procurements do not bring this number of bids in most instances.

The Rule of Two effectively came into being in FY 1981. It was promulgated in July 1979, but because of distribution delays and changes did not have significant impact in FY 1980. Our analysis of DOD data reflects that increases attributable to the impact of the rule were 35.8 percent in FY 1981; 19.0 percent in FY 1982; 4.4 percent in FY 1983; and are projected at over 6 percent in FY 1984. These data reflect percentage increases in the small business share of the DOD procurement dollars in the set-aside program and are adjusted so that small purchase set-asides are not included.

Since the civilian agencies have only been subject to the rule since April 1984, and final FY 1984 data are not available from the Federal Procurement Data Center, we have made no attempt to analyze projected data.

We must conclude that since the above data reflect the greatest increase in small business participation in the program's history in DOD, elimination of the rule will result in substantially reduced set-asides.

This is not to say that the program is free of problems. We believe, however, that the effect of having no guidance to Contracting Officers as to when to set a procurement aside will adversely affect small business participation in Federal procurement programs. This will have the attendant effect of limiting growth in the industrial base encouraged in the Small Business Act and Public Law 98-577. Further, the return to the Treasury in taxes from small business is generally considered greater because many small businesses pay taxes as individuals without the more favorable corporate rates.

When using numbers to describe competition, the phrase "two or more" as found in Section 19.502 of the FAR is almost universally used. This can be misleading because in most instances there are far more than two small businesses interested in a given procurement. We think that the proposed language is too vague and that using another number would have little or no effect.

There are approaches which would provide a contracting officer flexibility in ensuring free and open competition while preserving the Rule of Two. We think that these alternatives should be examined in establishing policy concerning set-asides. We further believe other independent factors may operate with

the Rule of Two to produce undesired results in certain industries. We suggest an examination of those factors and their effect before eliminating the rule.

We would be happy to participate with the Office of Federal Procurement Policy and the two Councils in reviewing comments on the Rule of Two and working to achieve the goals of increased industrial capacity, free and open competition, and savings to the taxpayers.

Yours truly,

/s/ Irene Castillo

for James C. Sanders
Administrator

THE DEPUTY SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

5 APR 1985

Mr. Donald W. Tidd
President
Association of Small Research, Engineering
and Technical Services Companies
P. O. Box 6306
McLean, Virginia 22106

Dear Mr. Tidd:

Thank you for your letter requesting my office to support the "Rule of Two or More" because of the adverse effects a revision of this rule would have on the small business community.

The "Rule of Two or More" was adopted by the Navy in the early sixties and implemented throughout the Department of Defense in July, 1979. Since then, we have seen small business set-asides grow from 7.2% to 10.0% of our prime contract awards. This increase has occurred in spite of a changing procurement mix that resulted in larger expenditures for major weapons systems.

Our support of the "Rule of Two or More" is very clear, as evidenced by the enclosure. Additionally, I have personally expressed my concern to the Deputy Director of the Office of Management and Budget that this rule be retained unchanged.

We appreciate the support provided to the Department of Defense by your association and its members. You may be assured of our best efforts to retain the "Rule of Two or More."

Sincerely,

William H. Taft IV

William H. Taft, IV

Enclosure

OFFICE OF THE UNDER SECRETARY OF DEFENSE
WASHINGTON DC 20301 3051

RESEARCH AND
ENGINEERING
(AM)

31 DEC 1984

Mr. William Maraist
Office of Federal Procurement Policy
Office of Management and Budget
726 Jackson Place
Washington, D.C. 20503

Dear Mr. Maraist:

The following is submitted on behalf of the Department of Defense in response to your Federal Register Notice Vol. 49, No. 199 of October 12, 1984 seeking comments on the "rule of two or more."

To accomplish the purpose of the Small Business Act, Congress authorized the use of a set-aside procurement method for any contract (or part of a contract) whenever it is determined: "(1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns, or (4) to be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns..." It should be noted that the first two justifications deal with benefits that accrue not to the small business community but rather to the Government (underscoring added.)

The only mechanism available to carry out this Congressional mandate is through the small business set-aside program, which serves as the underpinning of the Federal agencies small business programs.

FAR subsection 19.502-2 represents our best efforts to comply with the direction of Congress to support the small business community. Our procurement regulations establish procedures for both total and partial small business set-aside programs (FPR 1-1.706; DAR 1-706; NASA PR 1.706). These have worked effectively for almost thirty years to enhance the opportunities for small business and small disadvantaged business firms to participate in the acquisition of products and services by Federal agencies.

Enclosure

Current FAR coverage at 19.502-2 gives the Executive Agencies a precise formula for deciding when to use a small business set-aside. Until the procurement regulations were amended to include the "rule of two or more," as a firm standard, the only measure for deciding to make a small business set-aside was whether there was "a reasonable expectation" that a "sufficient number" of responsible small business firms would submit offers "at reasonable prices." The "sufficient number" standard was open to broad interpretation and proved inadequate; there was inconsistency of application from one contracting office to another within any given agency and certainly across the Federal Government.

The initial version of the FAR (Phase I) circulated for comment did not reflect the "rule of two or more" because it was based on the Federal Procurement Regulation (FPR) that enunciated only the "sufficient number" criterion. Virtually all the public comments received on FAR 19.502-2 (including those of DoD, GSA, NASA, and SBA) requested it be amended to include the "rule of two or more." There were two main concerns reflected in the commentors' remarks. The "rule of two or more" is required to be followed in placing small purchases in accordance with P.L. 95-507. It is logical to follow that policy for other procurements if procuring agencies are to accomplish the mandate of the Armed Services Procurement Act of 1947, the Federal Property and Administrative Services Act of 1949, the Competition in Contracting Act of 1984, and the Small Business Act;-i.e., to ensure that small businesses receive a fair share of the total of Federal contracts. Secondly, the old "sufficient number" standard is difficult to interpret, leaving the decision to thousands of buyers and contracting officers throughout the entire Federal establishment. This produces confusion not only for procurement personnel but also for the Small Business Administration and for the thousands of small business and small disadvantaged business firms throughout the country which support the various procuring agencies of the Federal establishments. This confusion resulted from the lack of knowledge and consistency of application as to what was the precise quantification of the sufficiency of expected responses from the small business community to justify the setting aside of a procurement for exclusive participation by small business firms.

Our surveillance reviews showed that in numerous cases contracting officers did not set aside a procurement for small business when their bidder's mailing lists contained in excess of 15-20 small firms that had registered a capability to provide a required product or service. For example, this

situation resulted in DoD's set-asides averaging only approximately 6% of its annual expenditures with U.S. business firms. Within the Department of Defense, the Navy Department had established the "rule of two or more" in their Navy Procurement Regulations (NPR) in 1964. With the passage of the Amendment to the Small Business Act (Public Law 95-507) and the requirement to revise the Defense Acquisition Regulation (DAR) to include the provisions of this amendment, the DoD reviewed the Navy's rule of two or more for DoD-wide application and codification in the DAR. This review indicated that competition is binary, - it exists or it does not, - or more specifically, a solicitation/contract award is either sole source or it's competitive. DoD, like other Federal agencies, records awards as being competitive whenever offers are received from two or more business firms. Accordingly, the test of sufficiency of competition to set-aside a procurement for exclusive participation by small business firms is satified when there is reasonable expectation that offers will be received from two or more small business firms. We do not believe we should have one standard for measuring competition for non-small business set-asides and a different standard as to what constitutes competition necessary for a small business set-aside.

Codification of such sufficiency of competition was included in the DAR on July 27, 1978 and has contributed to increasing the rate of set-asides to only 10.0% in FY 1984 ($112.5 billion or 90.0% of DoD's total awards of $124.9 billion were made by other than small business set-aside).

It should be noted that DoD alone processed 14.8 million procurement actions during FY 1984. The majority of these actions were processed by automated procurement systems. In the design of such systems the old approach of using the term "sufficient" could not be used, quantification was and is mandatory in the establishment and operation of these automated procurement ordering and reporting systems. It should also be noted, there have been several Comptroller General cases which have substantiated the legality of this policy.

We would like to note that small business set-asides generally result in more, not less competition. This increase in competition results because of two factors: (1) there is a much larger number of small business firms than big business firms; (2) the small business community perceives that when a procurement is set-aside, it, by definition, can not be a sole source award and that they will be competing against their peers and therefore stand a realistic chance of winning the contract.

The practice of setting aside procurements for small businesses has long been accepted as Congressional policy and that of past and present Administrations. It should also be noted, there have been several Comptroller General cases which have substantiated the legality of this policy. Thus, the FAR merely continues a long-standing practice of partial and total set-asides. However, the FAR settled on language that was consistent with the DAR and NASA Procurement Regulations to eliminate the problem being experienced under the Federal Procurement Regulations (FPR) as to how many firms constituted a "sufficient number" to warrant a set aside. Therefore, the current FAR language only represents new policy for former FPR users of the Federal civilian agencies other than NASA. It reflects a policy that has been in effect for over 20 years in the Navy, almost five years DoD-wide and approximately one and one-half years at NASA.

The published version of the FAR reflects the negotiated agreement between the three procurement regulatory agencies, (DoD, GSA, and NASA) to arrive at a workable standard for small business set-asides in order to provide for the required consistency of application needed across the Federal government. We do not view the FAR language as permitting one economic group to take over the Federal market place. Small business set asides are used to attain the small business participation goals set pursuant to Public Law 95-507 (15 U.S. 644), and not to deprive large business of its share or to unduly limit the competitive field. We do not feel that the FAR language violates current law but rather that it reflects the will of Congress as expressed in the Small Business Act.

In summary, FAR 19.502-2 was written to conform to the public comments received when the first version of the FAR was circulated and, as previously stated, is in furtherance of the mandate to ensure that small business receive a fair proportion of Government contract awards. In view of this, we see no valid reason to change the FAR language.

Sincerely,

Eleanor Spector

ELEANOR R. SPECTOR
ACTING DEPUTY UNDER SECRETARY
(ACQUISITION MANAGEMENT)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 17 1986

MEMORANDUM FOR: JAMES C. MILLER III
JOSEPH R. WRIGHT, JR.

FROM: David F. Baker, Acting Administrator

SUBJECT: OFPP Weekly Activity Report

I. SIGNIFICANT EVENTS

A. Proposed Action on the Rule-of-Two

We have drafted two different approaches to resolve the Rule-of-Two issue. The first represents the compromise position Bill Mathis talked to you about, Joe, and is in the form of an OFPP Policy Letter. This approach does not go so far as to eliminate the rule but it does require the addition of language which would address the problem that Brooks' staff said was at the heart of their concern. The second approach is based upon our understanding that you wish the rule eliminated altogether. It takes the form of a notice from the Administrator to DoD, GSA, and NASA stating that regulations (substantially in accordance with language provided in the notice) must be published in order to implement the Competition in Contracting Act. This approach relies on OFPP's authority to issue regulations if DoD, GSA, and NASA do not issue regulations in a timely manner, and is in accordance with the procedures contained in our Policy Letter 85-1. The effect of this change would delete the rule entirely, in favor of the "sufficient number" standard. We have provided copies of both approaches to the General Counsel's office which, we understand, will be discussing them with you.

HANDLING

☐ Urgent! (Hand-carry) ☐ Expedite (Time sensitive) ☐ Regular Handling

☐ Decision Memo ☐ Information Memo Control # ______

☐ Correspondence Outgoing to Secretary of Defense
Administrators, NASA and GSA

SPECIAL HANDLING INSTRUCTIONS

SHORT SUMMARY OF MATERIAL

We understand from the General Counsel's staff, Joe, that you have concluded that the "rule of two" should be cancelled and that you have directed that we take the necessary action, under authorities provided by the OFPP Act, to initiate that process. I share the reservations that Bill Mathis discussed with you on several prior occasions regarding cancellation of the rule; reservations that are also shared by many in the Federal procurement community. But, recognizing this as a legitimate policy option for the Administration to pursue, I have prepared a notice to the heads of the three procurement regulatory agencies directing them to issue for public comment a modification of the pertinent parts of the Federal Acquisition Regulation, replacing the "rule of two" with the "sufficient number" standard.

5063-3

	PREPARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY	CLEARED BY
NAME AND DIVISION	Baker OFPP	Dineen AD/M	Gramm OIRA	Cafley GC	Wright DO		
INITIALS AND DATE	2/10/86	2/11/86	wlg 2/12/86	JHC 2/10/86	2/2		

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

FEB 21 1986

MEMORANDUM TO: SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses "...if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices."

However, in July 1984, Section 2732 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. Therefore, further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter 85-1 that within 30 days of the date of this letter the following proposed regulations must be published for a 30 day comment period. This notice has been concurred in by the Director, OMB.

PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 — SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 — Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 — SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 6 1986

MEMORANDUM FOR: JAMES C. MILLER III
JOSEPH R. WRIGHT, JR.

FROM: David
David F. Baker
Acting Administrator

SUBJECT: OFPP Weekly Activity Report

II. PENDING MATTER

A. "Rule-of-Two" Controversy

The reaction is beginning to build to my issuance, on February 21st, of an instruction to DoD, GSA and NASA to begin the process of eliminating the "rule-of-two" from the Federal Acquisition Regulation and replacing it with the "sufficient number" standard. Parren Mitchell characterized it as an effort on the part of the Administration to end small business set-aside programs and to increase Federal contracts to large businesses. Yesterday, Mitchell and several of his colleagues on the House Small Business Committee wrote the three agencies, explaining why our interpretation of the statute was incorrect, and requesting that the proposed change not be implemented until the three agencies have the opportunity to "present their positions ... directly to the President." We will continue to work with Jack Carley's staff in handling the situation.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 14, 1986

MEMORANDUM

TO: David Baker

FROM: Diane Weinstein DW

SUBJECT: Rule of Two Q & As

I enclose my cut at the Q & As. Bold face material is new; old material is crossed out.

c: Jack Carley

3/14

David,

I have discussed Diane's suggestions with her and reach an agreement regarding what we would accept.

Bill Coleman

QUESTIONS AND ANSWERS REGARDING SMALL BUSINESS SET-ASIDES

A.1 The notice is intended to initiate action to replace the current procurement regulation governing small business set-asides **in the Federal Acquisition Regulation (FAR)** with one that ~~is in concert with~~ **fully implements** the Competition in Contracting Act of 1984 (CICA). . . .

The proposed rule, based upon wording in the statute, **abolishes any rule of thumb such as the rule of two and instead** requires that -- in order to set-aside a procurement -- contracting officers determine that the agency will receive a sufficient number of sealed bids or competitive proposals from responsible small business sources to fulfill the Government's requirements at the lowest reasonable cost. **The "sufficient number" standard is vey familiar to procurement officers who employed it for years in the civilian agencies before the FAR became effective in 1984.** The three procurement regulatory agencies (DOD, GSA, and NASA) have . . .

A.2. . . . under a procurement reserved exclusively for competition by small business. **In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DoD's utilization of the "rule of two," commenced only about 5 years before the FAR.**

A.4 . . . The regulations **will continue** to require that contracting officers review acquisitions to determine if they can be set-aside . . .

A.5 . . . is in a better position to respond **with a lower reasonable cost,** ~~from a cost standpoint~~, than ~~is~~ large business. . . . Only under circumstances where **it is determined that** the price from a large business is **would be** substantially lower than that proposed by small businesses would a set-aside be cancelled. **This is the case under current law as well.** The GAO has previously upheld cancellation of a set-aside procurement when information bids from large businesses indicated that the small business' price ~~is~~ **was** unreasonable.

A.6 The answer must be stated and understood in terms of the law that established the requirement. The CICA requires "full and open competition," which means all firms, large and small, must be allowed to compete. ~~It also requires "a sufficient number" of competitors to fulfill requirements at the "lowest reasonable cost."~~ ~~Both~~ **This** provision~~s~~ would appear to negate small business set-asides. However, CICA very clearly ~~exempted~~ **intended not to preclude** small business set-asides ~~from any in encumberance red~~ by the provisions of the Act. **Thus, the Act recognized that** full and open competition **could** ~~was stated in the Act to~~ exist when the competition ~~is~~ **was** conducted solely among small businesses. ~~Likewise, lowest reasonable cost must be read to mean the lowest reasonable cost among small businesses. Otherwise the expressed intent of Congress to retain the small business set-aside program would be violated.~~ **However, to set a procurement aside the contracting officer must reasonably foresee that competition conducted solely among small businesses is likely to result in the lowest reasonable cost.**

Q.7 Under the proposed rule, if a large business comes forward and shows the contracting officer, through catalogue prices or otherwise, that its price ~~is~~ **would be** substantially lower than the prices ~~paid by~~ **offered by** small business, will the contracting officer not set-aside the procurement?

A.7 The procurement would probably not be set-aside. However, it is important to know the reason. It is not **merely** because a large business expressed interest in the procurement. It is because the contracting officer must make awards at "reasonable" prices. **This is necessary to protect the Government from paying unreasonable costs. The small business set aside program was never intended to force the Government into set asides at substantially higher costs. The fear is that with any rule of thumb, particularly one set at only two, contracting officers may apply it automatically and fail to ascertain that there is a real likelihood of bids in the lowest reasonable cost range. Thus, he may automatically set-aside whenever two potential small business bidders can be identified, regardless of likely cost.** If the information supplied by the large business merely showed that it would be competitive with a sufficient number of small businesses that, in themselves, assure competition, the procurement would be set-aside. This response would also hold true ~~if asked with respect to~~ the "rule of two." . . .

A.8 If the regulatory agencies fail to issue proposed regulations by March 23, 1986, OFPP ~~will attempt to discuss why such proposed regulations have not been issued.~~ If it

~~appears that proposed regulations are imminent (2-or-3) days), no action will be taken. If proposed regulations are not imminent, OFPP~~ will utilize its . . .

A.9 **There was some limited internal discussion with the SBA prior to OFPP's decision to request the three agencies to issue the rule. The rule has not yet been issued in final form. Interested parties will have a full opportunity to express their views on the proposed rule for the record** ~~There was no discussion with the small~~ business community ~~prior to issuance. It was not discussed because the proposed regulation results from a legal interpretation of the provisions of Section 2732 of the Competition in~~ Contracting ~~Act of 1984. The proposed regulation is, therefore, not considered a matter of policy wherein OFPP would discuss its proposal with interested~~ parties. ~~In this case, interested parties~~ may express ~~their~~ views during the public comment period, **as, for that matter, they are now doing informally.** true

A.10 After its initial review of the provisions of CICA, OFPP did not conclude that a revision of the regulations addressing small business set-asides was required by the statute. **However, after criticism that the rule of two had been included in the FAR without providing adequate public notice and opportunity for comment, OFPP published a Notice of Comment on Oct. 12, 1984. 49 Fed. Reg. 40135. Many commenters noted that CICA, which was to become effective on April 1, 1985, evidenced Congress' concern with the continuing legality and appropriateness of noncompetitive procedures such as the rule of two in set-aside situations.** In December 1984, Congressmen Jack Brooks and Frank Horton and Senators William Cohen and Carl Levin wrote to the regulatory agencies concerning the proposed FAR implementaiton of CICA. Among the matters which they pointed out was the fact that "rule of two," contained in FAR Part 19, was not appropriate in view of the language in Section 2732 of CICA regarding "sufficient number" and "lowest reasonable cost." They, **also** ~~further,~~ stated that it was their intent, as co-sponsors of the legislation, to eliminate the "rule of two." The regulatory agencies disagreed, in a response to the members in August 1985. The matter was raised again in December 1985, by a letter from Congressmen Jack Brooks and Frank Horton to Joseph Wright, Deputy Director of OMB, asserting their view that the "rule of two" was contrary to the CICA. ~~After a coordinated review by the OFPP and the General Counsel of OMB, it was concluded that the provisions of the CICA require that the~~ **After considering the comments on the October 1984 notice of comment and the provisions of CICA,**

OFPP decided to issue for public comment proposed regulations be revised to substitut**ing** the "sufficient number/lowest reasonable cost" formula **in CICA** for the "at least two/reasonable price" formula **in the current FAR.**

A.11. . . .

~~In the event that~~ **Only if** a firm which is included in the 8(a) program ~~chooses to~~ seeks direct procurements independent of the program, ~~it would~~ **would it** be subject to the standard FAR provisions, including the set-aside regulations.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 18 1986

MEMORANDUM FOR BRYCE HARLOW
ED DALE

FROM: David Baker

SUBJECT: Rule-of-Two Controversy

On February 21st, we issued an instruction to the Federal procurement regulatory agencies (DoD, NASA, GSA) to amend the regulations pertaining to small business set-asides, to bring the regulations into accord with the Competition in Contracting Act of 1984. That change is being vociferously opposed by the small business community and its champions on the Hill.

To assist you in responding to any inquiries you may receive from the press, Congressional staff or others, we have developed a series of questions and answers (attached) that explain the basis, intent and likely effects of our action.

I hope you will find them useful.

Attachment

c: C. Dineen
S. Tupper

QUESTIONS AND ANSWERS REGARDING SMALL BUSINESS SET-ASIDES

Q.1. What is the intended effect of the instruction to agencies to publish a proposed small business set-aside regulation, as issued by OFPP on February 21, 1986.

A.1. The notice is intended to initiate action to replace the current procurement regulation governing small business set-asides in the Federal Acquisition Regulation (FAR) with one that fully implements the Competition in Contracting Act of 1984 (CICA). The current regulation requires that contracting officers set-aside a procurement for exclusive small business participation where "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns, and (b) awards will be made at reasonable prices."

The proposed rule, based upon wording in the statute, abolishes any rule of thumb such as the rule of two and, instead, requires that — in order to set-aside a procurement — contracting officers determine that the agency will receive a sufficient number of sealed bids or competitive proposals from responsible small business sources to fulfill the Government's requirements at the lowest reasonable cost. The "sufficient number" standard is familiar to procurement officers who employed it for years in the civilian agencies before the FAR became effective in 1984. The three procurement regulatory agencies (DOD, GSA, and NASA) have been instructed to initiate the regulatory change by publishing the proposed regulation by March 23, 1986, for a 30-day period for public comment.

Q.2. Will elimination of the "rule of two" end small business set-asides?

A.2. No. Contracting officials will evaluate planned procurements in the same manner under the proposed regulations as they do under the current system. They will evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will review the purchase history of the item or service to determine if it has been previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DOD's utilization of the "rule of two" commenced only about 5 years before the FAR.

Q.3. What is the Administration's position on preferential procurement programs, generally, and on small business set-asides, in particular?

A.3. The Administration has consistently expressed support for programs which promote the development and growth of small businesses. To illustrate: small business set-asides were supported as part of the Administration's Proposal for a Uniform Federal Procurement System submitted to the Congress in February 1982. The legislative proposal which was submitted to implement the proposal served as a basis for the competition provisions of

the Competition in Contracting Act of 1984 (P.L. 98-369), which recognizes small business set-asides as instances of "full and open competition" limited to small business contractors. Moreover, the President signed a proclamation last month declaring a National Small Business Week.

Q.4. If the "sufficient number/lowest reasonable cost" formula is implemented, what will be the effect upon the number of small business set-asides? (Some commenters have stated they will be reduced by 50%.) Shouldn't that be determined before such a regulation is adopted?

A.4. The legal effect of Section 2732 of the Competition in Contracting Act of 1984 imposes the "sufficient number/lowest reasonable cost" formula as a matter of law. The effect on the number of set-asides by adoption of this formula is not a matter which can alter adoption of the formula. Although the precise effect is impossible to calculate, as a practical matter, it does not appear that adoption of the formula will reduce the number of small business set-asides. There may be a temporary reduction until agency contracting personnel become familiar with the revised regulations. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Small Business Act. The regulations will continue to require that contracting officers review acquisitions to determine if they can be set-aside and provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Q.5. Will adoption of the "lowest reasonable cost" standard give any big business the opportunity to veto or set-aside merely by saying it is interested in submitting an offer?

A.5. No. Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond than large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (P.L. 98-369, the Competition in Contracting Act of 1984, and P.L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business would be substantially lower than that proposed by small business would a set-aside be cancelled. This is the case under current law as well. The GAO has previously upheld cancellation of a set-aside procurement when information bids from large businesses indicated that the small business' price was unreasonable.

Q.6. How could any contracting officer be assured of having the "lowest reasonable cost" if he does not let large businesses bid?

A.6. The answer must be stated and understood in terms of the law that established the requirement. The CICA requires "full and open competition," which means all firms, large and small, must be allowed to compete. This provision would appear to negate small business set-asides. However, CICA very clearly intended not to preclude small busines set-asides. Thus, the Act recognized that full and open competition could exist when the competition is conducted solely among small businesses. However, to set a procurement aside, the contracting officer must reasonably foresee that competition conducted solely among small businesses is likely to result in the lowest reasonable cost.

Q.7. Under the proposed rule, if a large business comes forward and shows the contracting officer, through catalogue prices or otherwise, that its price would be substantially lower than the prices offered by small business, will the contracting officer not set-aside the procurement?

A.7. The procurement would probably not be set-aside. However, it is important to know the reason. It is not merely because a large business expressed interest in the procurement. It is because the contracting officer must make awards at "reasonable" prices. This is necessary to protect the Government from paying unreasonable costs. The fear is that with any rule of thumb, particularly one set at only two, contracting officers may apply it automatically and fail to ascertain that there is a real likelihood of bids in the lowest reasonable cost range. If the information supplied by the large business merely showed that it would be competitive with a sufficient number of small businesses that, in themselves, assure competition, the procurement would be set-aside. This response would also hold true under the "rule of two." This regulation also does not allow a bad business decision by the contracting officer. In addition to having "at least two" small businesses, the contracting officer must determine that the competition will result in reasonable prices. If confronted with the same information from the same large business (substantially lower price), the procurement would not be set-aside even under the "rule of two."

Q.8. What will OFPP do if the three regulatory agencies fail to issue the regulation for comment by March 23, 1986? Will it issue a draft policy letter for comment?

A.8. If the regulatory agencies fail to issue proposed regulations by March 23, 1986, OFPP will utilize its regulatory authority under the OFPP Act (41 USC 405) and, as outlined in OFPP Policy Letter 85-1, issue proposed regulations to be implemented in the Federal Acquisition Regulation for 30 days' public comment. We fully expect, however, that such action will not be necessary.

Q.9. Was this proposed regulation discussed, at least informally, with representatives of the small business community (i.e., SBA, SADBUs, appropriate Congressional staff) prior to issuance? If not, why not?

A.9. There was some limited internal discussion with executive branch agencies, including the SBA, prior to OFPP's decision to request the three agencies to

issue the rule. The rule has not yet been issued in final form. Interested parties will have a full opportunity to express their views on the proposed rule for the record.

Q.10 If the CICA is what caused OFPP to issue the proposed instruction, why did OFPP wait over 18 months to do so? Specifically, what triggered this action?

A.10. After its initial review of the provisions of CICA, OFPP did not conclude that a revision of the regulations addressing small business set-asides was required by the statute. However, after criticism that the rule of two had been included in the FAR without providing adequate public notice and opportunity for comment, OFPP published a Notice of Comment on October 12, 1984. 49 Fed. Reg. 40135. Many commenters noted that CICA, which was to become effective on April 1, 1985, evidenced Congress' concern with the continuing legality and appropriateness of the rule of two in set-aside situations. In December 1984, Congresman Jack Brooks and Frank Horton and Senators William Cohen and Carl Levin wrote to the regulatory agencies concerning the proposed FAR implementation of CICA. Among the matters which they pointed out was the fact that "rule of two," contained in FAR Part 19, was not appropriate in view of the language in Section 2732 of CICA regarding "sufficient number" and "lowest reasonable cost." They also stated that it was their intent, as co-sponsors of the legislation, to eliminate the "rule of two." The regulatory agencies disagreed, in a reaponse to the members in August 1985. The matter was raised again in December 1985, by a letter from Congressmen Jack Brooks and Frank Horton to Joseph Wright, Deputy Director of OMB, asserting their view that the "rule of two" was contrary to the CICA. After considering the comments on the October 1984 notice of comment and the provisions of CICA, OFPP decided to issue for public comment proposed regulations substituting the "sufficient number/lowest reasonable cost" formula in CICA for the "at least two/reasonable price" formula in the current FAR.

Q.11. Does the proposed approach apply to 8(a) firms — and the process by which they are awarded contracts? If not, why not?

A.11. The proposed approach will not apply to firms which are awarded subcontracts under Section 8(a) of the Small Business Act. It should be noted that Section 8(a) of the Small Business Act authorizes the Small Business Administration to enter into direct contracts with Federal agencies to provide goods and services by subcontracting the actual performance to small business firms which have been accepted into the business development program established by the Act. The regulations and procedures for 8(a) contracts and subcontracts are separate and apart from those governing small business set-asides and are unaffected by the OFPP notice.

Only if a firm which is included in the 8(a) program seeks direct procurements independent of the program, would it be subject to the standard FAR provisions, including the set-aside regulations.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

[illegible]

March 18, 1986

MEMORANDUM FOR CAROL CRAWFORD

FROM: Susan Tanaka STanaka

SUBJECT: Small Business Procurement Set-Aside Controversy

The purpose of this memorandum is to provide you with information on a procurement issue that is creating concern among the small business community and is having an adverse impact on our legislative strategy for the Small Business Administration Budget proposal. No action on your part is required at this time. However, you may be questioned about this issue when you address small business groups.

Background

Over the past year, OMB, through the Office of Federal Procurement Policy (OFPP), the General Counsel, and the Deputy Director, has been engaged in discussions with the Government Operations and Government Affairs Committees of the House and Senate concerning implementation of the Competition in Contracting Act of 1984 (CICA). An issue of specific concern to House Committee Chairman Jack Brooks (D-TX) is the "rule of two," used in the Federal Acquisition Regulations (FAR) by Government procurement officers to decide whether or not a contract should be set-aside for small business bid. The "rule of two" means that if the procuring officer has a reasonable expectation that at least two or more small businesses are likely to offer bids at "reasonable" prices for a contract, the contract should be set-aside for exclusive bid by small businesses.

CICA states that procuring agencies must use procedures that assure that a "sufficient number" of bids are received so that the contract can be fulfilled at the "lowest reasonable cost." The Conference Report states that this requirement applies to procurements made under set-aside programs.

Lengthy discussions within OMB between OFPP, GC, and the Deputy Director took place on this issue. At the direction of the Deputy Director, OFPP issued a memorandum (Attachment A) on February 21 to the Department of Defense, NASA, and GSA (the largest procuring agencies) instructing them to revise their procurement regulations to conform with CICA and to publish the proposed rules for a 30-day comment period. The Congressional committees were notified of OFPP action on March 5 (Attachment B). TCJ staff learned of this issue through a Wall Street Journal article published on March 4 (Attachment C). The House Small Business Committee's reaction to OFPP's action is also attached (Attachment D).

Current Status

The small business procurement community is concerned that the revised procedures will effectively eliminate small business set-asides. They fear that procuring officers will feel that the only way to meet the CICA requirement is through open competition. The decision about what constitutes a "sufficient" number and the "lowest reasonable cost" would be left to each individual procurement officer. Since more than two bids are usually received (the average is 6 or 7 in some procuring agencies), SBA staff advise that a "rule of four" or some other definite number would be preferrable than an unspecified "sufficient" number and argue that the assumption should be made that this competition will assure the "lowest reasonable cost" requirement is being met.

OFPP staff believe that the small business concerns can be aired during the public comment period once the agencies have developed their revised rules and will be adequately addressed at that time.

TCJ staff do not have a substantive objection to the OFPP action, but are concerned about the lack of coordination and the timing. As you know, we are currently trying to convince the small business community that the budget proposal supports the small business procurement set-aside program and that even the proposal to eliminate the Procurement Center Representatives (PCRs) would not harm small business interests.

Congressman Dreier's (R-CA) staff have indicated that the PCRs will be restored in the SBA bill the Congressman introduces. This is a direct result of the OFPP action, and is an attempt to calm the fears of the small business community and to keep this issue from ruining the chances of our budget proposal. In addition, a legislative attempt to "correct" past Congressional action may be made to alter the lowest reasonable price provision as it applies to small business set-asides.

OMB is already in the awkward situation of appearing to be speaking out of both sides of our mouth (OFPP appears to be trying to eliminate small business set-asides; the budget side is saying that we are not trying to harm the procurement programs.) If OMB is forced to take a position on the "corrective" action, we will either confirm an apparent anti-small business set-aside position, or we risk antagonizing Congressman Brooks. In the meantime, in response to inquiries, TCJ staff are explaining that the OMB (OFPP) action is required by Congressional action.

TCJ staff will keep you informed about developments as they relate to our legislative strategy for the SBA proposal.

Attachments

Maraist

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 24 1986

MEMORANDUM FOR JOSEPH WRIGHT, JR.

FROM: David F. Baker

SUBJECT: Rule of Two

This will provide background information for your meeting with the deputies of DoD, GSA and NASA, which I understand that Amanda is setting up (in accordance with your instructions) for tomorrow, Tuesday, March 25th.

- On February 21st, we instructed the three procurement regulatory agencies to issue for comment within 30 days a proposed regulation that would replace the "rule of two" with the "sufficient number" formula - for use by contracting officers in making small business set-aside determinations. (Our February 21st instruction is attached at Tab A.) Today was the deadline for the agencies to publish the instruction for comment.

- Last Friday, I was contacted by Eleanor Spector - the head of DoD's procurement policy office - who said that the three agencies had concluded that they would not comply with our instruction. She said that this noncompliance was not due to their opposition to the substance of the regulatory change - but to the fact that we had not followed the specific requirements of the OFPP Policy Letter 85-1 (which sets out the procedures for OFPP's involvement in the regulatory process.)

- She also said that she understands that DoD's small business advocate had prepared a letter for Weinberger's signature to Jim Miller outlining DoD's substantive opposition to the proposed policy change, and asking that it be withdrawn. The important point that I garnered from Spector's call is that the political level in the agencies has not yet grappled with this issue, only the professional procurement people. So there still should be time to influence Will Taft (DoD), Paul Trause (GSA) and Bill Graham (NASA). (A more complete account of my conversation with E. Spector is attached at Tab B).

- The reaction, incidentally, to our February 21st instruction has been fairly muted. Predictably, the House Small Business Committee is upset with the decision (See Tab C) and has begun to orchestrate opposition in the small business community to our proposed change. There have been multiple Congressional and press inquiries regarding our action - but our responses to those questions have been generally well received. (Enclosed at Tab D are questions and answers, jointly developed with Jack Carley's staff, that describe the purpose of our February 21st instruction - and its likely effects. I suggest you may wish to read through these fairly carefully prior to your meeting with the three deputies.)

- The principal points which need to be made to the agency deputies, I believe, are these:

  (1) Our instruction to the agencies is clearly in accordance with, and required by, the Competition in Contracting Act of 1984 - which explicitly requires that the "sufficient number" formula be adopted. (The fact that we did not follow all the procedural requirements of our own Policy Letter is irrelevant and simply serves as a convenient excuse for the agencies not to act and, thus, avoid the heat generated by the small business community.)

  (2) The "sufficient number" formula is not new. A variation of it was used by the civil agencies prior to issuance of the FAR for many years - without any obvious deleterious effects on the small business set-aside program.

  (3) We are convinced that the effect of our proposed change will be minimal in terms of reducing the actual number of procurements set-aside for small businesses. Contracting officers simply will have a bit more discretion in making those set-aside decisions.

We will be pleased to discuss this matters further with you at your convenience.

Attachments

c: J. Carley
C. Dineen
C. Crawford

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

FEB 21 1986

MEMORANDUM TO: SECRETARY OF DEFENSE
ADMINISTRATOR OF NATIONAL AERONAUTICS AND SPACE ADMINISTRATION
ADMINISTRATOR OF GENERAL SERVICES

FROM: DAVID F. BAKER, ACTING ADMINISTRATOR

SUBJECT: Small Business Set-Aside Determination Provisions of FAR

The current FAR standard for making a small business set-aside determination is found at FAR 19.502-2. It provides that an agency must set aside a procurement for small businesses "...if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns offering the products of different small business concerns, and (b) awards will be made at reasonable prices."

However, in July 1984, Section 2733 of the Competition in Contracting Act of 1984 (CICA) amended section 16(1) of the OFPP Act to read as follows:

> "... the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
>
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.)

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)

Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals ... /to achieve/ the lowest reasonable cost..." as a standard of competition for all procurements "...including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a sufficient number of small business bids or proposals to fulfill the Government's requirements at the lowest reasonable cost. Therefore, further amendment of the Federal Acquisition Regulation is required to complete the full and proper implementation of the Competition in Contracting Act (CICA) of 1984. Section 2733 expresses a standard of competition for all Federal procurement that has not been directly implemented in the FAR with respect to procurements under the small business set-aside program.

The standard of competition established by CICA applies to a procurement that has been set-aside for small business. Therefore, before any procurement may be set-aside, the contracting officer must have a reasonable expectation that the standard will be met.

The purpose of this letter is to provide notice under the provisions of OFPP Policy Letter 85-1 that within 30 days of the date of this letter the following proposed regulations must be published for a 30 day comment period. This notice has been concurred in by the Director, OMB.

PART 6 — COMPETITION REQUIREMENTS

Subpart 6.1 — Full and Open Competition

1. Section 6.101, Policy, is amended to add paragraph (c) as follows:

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19 — SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

Subpart 19.5 — Set-Asides for Small Business

Section 19.501 General

2. Section 19.501 is amended to revise paragraph (g) as follows:

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

SECTION 19.502 — SETTING ASIDE ACQUISITIONS

3. Section 19.502.2 is amended to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-asides, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history of an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

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MAJORITY—225-5821
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AREA CODE 202

March 4, 1986

Honorable Caspar W. Weinberger
Secretary
Department of Defense
The Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

This Committee has received a copy of a February 21, 1986 memorandum authored by David F. Baker, Acting Administrator of the Office of Federal Procurement Policy (OFPP), and addressed to the Secretary of Defense and the Administrators of the National Aeronautics and Space Administration (NASA) and the General Services Administration (GSA). This memorandum purports to exercise OFPP's authority pursuant to 41 U.S.C. section 405, as implemented by OFPP Letter 85-1. The subject of the memorandum is the "Small Business Set-Aside Determination Provisions of FAR."

We have reviewed the memorandum and, for the reasons stated below, do not believe it was issued "with due regard for applicable laws and the program activities of the executive agencies" (41 U.S.C. section 405(a)). Accordingly, we recommend that DoD, NASA, and GSA delay any requested publication until the issue of OFPP compliance with the statute is resolved by the President.

OFPP claims that the subject memorandum is required by section 2733 of the Competition in Contracting Act of 1984 (CICA). That provision amended section 16(1) of the OFPP Act to read as follows:

> "To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> (1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;"

Reading this statutory provision OFPP has concluded that:

(1) the so-called "rule of two" found in section 19.502 of the FAR should be repealed;

(2) a set-aside cannot take place unless the contracting officer demonstrates that a sufficient number of responsible small business concerns "will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost ...";

(3) a class set-aside cannot take place unless the contracting officer makes a written determination that the demonstration referred to in (2) "can be achieved on each procurement in that class, evaluating in detail ... quality, timeliness and cost factors"; and

(4) a repetitive set-aside cannot take place unless the contracting officer makes a written determination reaffirming that small business will submit the lowest reasonable cost.

OFPP's extreme interpretation is in contradiction with the clear meaning of relevant provisions of the CICA.

As you know, CICA amended, among other things, both the Federal Property and Administrative Services Act (FPASA) and, what is commonly referred to as the Armed Services Procurement Act (ASPA). For the sake of this discussion, we shall refer only to sections of the FPASA since CICA amends both statutes with identical provisions in the area here relevant.

Section 303(a) of FPASA generally requires that agencies obtain full and open competition through the use of competitive procedures. Subsection (b) of this same section, as amended by P.L. 98-577 (October 30, 1984), authorizes agencies to use competitive procedures but to exclude a specific source or, in the case of small business set-asides, to exclude all sources other than small business concerns.

Section 309(b) of FPASA, as amended by P.L. 98-577, defines competitive procedures as including small business set-asides "as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete."

Reading sections 303 and 309 together, it is clear that small business set-asides are to be deemed as full and open competition using competitive procedures provided that the buying agency does not limit the number of eligible small businesses that may submit an offer in response to a set-aside solicitation.

The provision cited by OFPP as requiring its proposed rule change (section 2733 of CICA, 42 U.S.C. section 414(1)), is a direction to Federal agency heads that, when implementing the FAR, they not adopt internal policies, procedures and practices that would unnecessarily restrict the number of otherwise eligible sources that could compete for the award. It is our impression that such unnecessary inhibitors to full and open competition may, in particular circumstances, include bonding requirements, restrictive specifications, geographic limitations, directed subcontracting sources, and other definitive elements of responsibility not justifiable in

light of the particular agency need in question. Such restrictions would, of course, militate against the use of full and open competition and its concomitant benefit of lowering costs. Our interpretation is fully consistent with sections 303 and 309 of the FPASA which preclude an agency from limiting the number of eligible small businesses that may compete for a set-aside. Indeed, if such a limitation would occur, that procurement would no longer be deemed full and open competition.

The "rule of two" has nothing whatsoever to do with a limitation on the number of eligible competing sources. The rule is applied prospectively (before the requirement is synopsized) by a contracting officer to determine whether a procurement should be set-aside -- not whether an eligible small business should be precluded from submitting an offer.

Aside from the fact that the proposed regulation is not required by CICA, the regulation, if adopted, would also have a detrimental effect on the Federal acquisition process. By way of illustration, consider the following:

(1) How can a contracting officer equitably administer a "lowest reasonable cost" standard when the particular acquisition in question may be awarded under source selection criteria that subordinate cost to technical merit?

(2) Can the "lowest reasonable cost" standard ever be met if a large business indicates an interest in submitting an offer?

(3) In those relatively few instances when the contracting officer can demonstrate that only small business will submit proposals and, therefore, that the "lowest reasonable cost" test will be satisfied, are not set-asides rendered meaningless since the awards will be made to small business regardless of the procurement strategy used? Is it reasonable for OFPP to assume that Congress intended to render the set-aside authority a practical nullity through the strained construction of a statutory provision that does not even mention set-asides?

(4) Why does CICA require "a reasonable expectation of receiving more than one sealed bid" as the standard for a sealed bid procurement (section 2711(a)(1)), but, as interpreted by OFPP, require a more stringent standard for small business set-asides?

(5) How can an agency expect its program activities to expand competition and the mobilization base (see section 15(a) of the Small Business Act) if it cannot limit the concentration of contracts through the use of set-asides?

(6) Would adoption of the regulation set a precedent that the Administrator of OFPP has the authority to implement -- through memoranda -- the responsibilities reserved to agency heads under 41 U.S.C. section 414?

We fully understand that certain buying agencies have experienced difficulties with set-asides in some industrial areas because of faulty size standards adopted by the Small Business Administration (SBA). However, we believe the solution to that problem is size standard reform, not the effective elimination of set-asides.

For the reasons cited above, we again urge that publication of the proposal be indefinitely delayed so that DoD, NASA, and GSA have an opportunity to present their positions on these most important issues directly to the President.

If you should have any questions regarding this letter, please have a member of your staff contact our Committee's Legislative Counsel, Tom Trimboli, at 225-4351.

Sincerely,

Joseph P Addabbo
Joseph P. Addabbo, M.C.

Parren J Mitchell
Parren J. Mitchell
Chairman

Berkley Bedell, M.C.

Nicholas Mavroules
Chairman, Subcommittee on General Oversight and the Economy

PJM:ttf

cc: Norma Leftwich, Director
Office of Small & Disadvantaged Business Utilization, Department of Defense

John Wynn, Director
Office of Small & Disadvantaged Business Utilization, General Services Administration

Eugene Rosen, Director
Office of Small & Disadvantaged Business Utilization, National Aeronautics and Space Administration

National Small Business Association
The Voice of Small Business"
Founded 1937

SPEAKING OF SMALL BUSINESS

"RULING" OUT SMALL BUSINESS

If you are one of the thousands of small firms doing business with the federal government, you are about to get sandbagged by the OFPP.

You've never heard of OFPP? It's the Office of Federal Procurement Policy, a low-profile, highly influential part of the bureaucracy that sets the rules by which the government contracting game is played.

The OFPP is part of the Office of Management and Budget and it wants to repeal the "rule of two". Getting rid of government regulations normally is a sound idea. In this instance, however, it's one of the worst ideas the bureaucracy has come up with. It ranks with the "contemporaneous" recordkeeping rule IRS issued last year on the use of business vehicles.

The "rule of two" says that when there are at least two responsible small firms bidding on a contract and the government can expect to pay a reasonable price, the contract must be "set aside" for bidding by small firms only. It does not mean that bidding is limited to two small firms. It does mean that big businesses cannot bid.

The rule has been in use by some agencies since 1964 and by all federal agencies since 1984.

Why is it so important? It insures that a small business is going to get the contract and the taxpayers are going to pay a reasonable price. If the figures the bureaucracy gives us are correct, small business gets about $30 billion a year in federal prime contracts. Nearly half of that,

$15.6 billion, came as the result of the "set-aside" program in FY 1984.

If the rule is repealed, it could cut small business' already meager take of the federal procurement dollar in half! Big businesses which represent only one percent of all businesses in the nation, already get 80% of the contract dollars. They stand to get even more if the "rule of two" is repealed.

The OFPP says it is complying with a provision of the Competition in Contracting Act of 1984. That section directs agencies to "increase the use of full and open competition. . ." by adopting policies, procedures and practices that assure the agency receives a sufficient number (emphasis supplied) of sealed bids.

The manner in which the OFPP has interpreted the Act, in effect, directs contracting officers to justify in writing, setting aside contracts for bidding by small firms only. More important, it in effect offers big businesses which already have complained that competition from small firms is "eroding" their sale of spare parts, a chance to have a "set-aside" rejected merely by indicating they might bid.

Getting the best price has not necessarily been contracting officers prime consideration. Remember $400 hammers and $640 toilet seats? Their main objective is to get the item delivered according to specificiations and on time. It is not reasonable to expect them to jeopardize that objective by making detailed surveys and written determinations prescribed in the proposed rule change.

The OFPP says its proposal complies with the law. Congress says OFPP is misinterpreting the law. If all this has a familiar ring to it, it should. Congress last year directed IRS to change the rules on justifying the use of business vehicles ~~to~~ For tax purposes. IRS did. However what they issued hardly overcame what Congress objected to in the first place and Congress is again taking IRS to task.

It is no secret that the person originally designated to draft proposed legislation sent to Congress, often is the one who gets it back for interpretation once Congress passes the law. It's an easy way for the Executive Branch to circumvent Congressional directives it doesn't completely agree with.

Repealing the "rule of two" is a bad idea. It will rule thousands of small businesses out of the federal marketplace. It will destroy the "set-aside" program that provides nearly half of all the contracting dollars small firms get from the government. It will likely impair to a serious degree the capital base of thousands of small businesses and worse, it will jeopardize even further the competitive position of small business and increase the concentration of federal contracting in big corporations.

If you are affected by and concerned with this proposal, be on the lookout for an announcement of its being published for public comment. Send your comments to the Director of the Office of Management and Budget. You should also let your Senators and Congressman know how you feel. If you write to us, we'll make certain your comments are passed on to the appropriate Congressional Committees for their action.

The "rule of two" was and continues to be a good rule for small business.

(SPEAKING OF SMALL BUSINESS is published monthly by the National Small Business Association, a bi-partisan, non-profit organization of small business owners, 1155 15th St. NW, Seventh Floor, Washington, DC 20005.)

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 21 1986

MEMORANDUM FOR RECORD

FROM: David F. Baker, Acting Administrator

SUBJECT: Regulatory Agency Response: Rule-of-Two

I was contacted today by Eleanor Spector (DoD's Deputy Assistant Secretary for Acquisition) at 1:20 p.m. regarding the procurement regulatory agencies' response to our February 21st instruction regarding replacement of the rule-of-two by the "sufficient number" formula. In the conference call, Ms. Spector indicated that she was in the company of Patricia Szervo (GSA's Associate Administrator for Acquisition Policy), Dennis Trosch (DoD General Counsel). and Larry Rizzi (FAR Executive Secretariat).

Ms. Spector informed me that the agencies had concluded that they would not comply with our February 21st instruction because the instruction did not reflect the process delineated in OMB Policy Letter 85-1. Specifically, she read the sentence from paragraph 7 that states, "... When the Administrator considers that a particular OFPP FAR change is not being resolved in a timely manner, the Administrator, after consultation with DoD, GSA and NASA, shall give notice and specify a time in which a decision must be reached regarding issuance of regulations." Ms. Spector pointed out that there had been no consultation or indication by OFPP of our disagreement with the agencies' view, or any indication of what constituted timeliness regarding the reaching of a decision on this issue -- and that, therefore, the OFPP instruction was contrary to the process which had been set up for this purpose.

I explained that while our instruction may not comply fully with the letter of 85-1, it was, nonetheless, a valid exercise of OFPP authority and reflected the Administration's desires with regard to the rule-of-two matter. And, while we would be disappointed if the agencies chose not to comply with our instruction, we would take whatever action was appropriate to implement the Administration's wishes.

Prior to concluding the conversation, Ms. Spector also volunteered the information that DoD's SADBU representative was preparing a letter for the Secretary's signature to the Director of OMB taking issue with the substance of the policy and pointing out its possible deleterious effects on small business. She again emphasized that while she did not personally question the Administration's right to issue the policy or the substance of the policy, she did question the form in which we did issue the instruction.

Upon reflection, I called Ms. Spector back to request that the substance of the preceeding conversation be provided to us officially and in writing. She said she would do so. She also said this decision had been cleared with L. Hopkins of NASA prior to her calling me.

QUESTIONS AND ANSWERS REGARDING SMALL BUSINESS SET-ASIDES

Q.1. What is the intended effect of the instruction to agencies to publish a proposed small business set-aside regulation, as issued by OFPP on February 21, 1986.

A.1. The notice is intended to initiate action to replace the current procurement regulation governing small business set-asides in the Federal Acquisition Regulation (FAR) with one that fully implements the Competition in Contracting Act of 1984 (CICA). The current regulation requires that contracting officers set-aside a procurement for exclusive small business participation where "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns, and (b) awards will be made at reasonable prices."

The proposed rule, based upon wording in the statute, abolishes any rule of thumb such as the rule of two and, instead, requires that — in order to set-aside a procurement — contracting officers determine that the agency will receive a sufficient number of sealed bids or competitive proposals from responsible small business sources to fulfill the Government's requirements at the lowest reasonable cost. The "sufficient number" standard is familiar to procurement officers who employed it for years in the civilian agencies before the FAR became effective in 1984. The three procurement regulatory agencies (DOD, GSA, and NASA) have been instructed to initiate the regulatory change by publishing the proposed regulation by March 23, 1986, for a 30-day period for public comment.

Q.2. Will elimination of the "rule of two" end small business set-asides?

A.2. No. Contracting officials will evaluate planned procurements in the same manner under the proposed regulations as they do under the current system. They will evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will review the purchase history of the item or service to determine if it has been previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DOD's utilization of the "rule of two" commenced only about 5 years before the FAR.

Q.3. What is the Administration's position on preferential procurement programs, generally, and on small business set-asides, in particular?

A.3. The Administration has consistently expressed support for programs which promote the development and growth of small businesses. To illustrate: small business set-asides were supported as part of the Administration's Proposal for a Uniform Federal Procurement System submitted to the Congress in February 1982. The legislative proposal which was submitted to implement the proposal served as a basis for the competition provisions of

the Competition in Contracting Act of 1984 (P.L. 98-369), which recognizes small business set-asides as instances of "full and open competition" limited to small business contractors. Moreover, the President signed a proclamation last month declaring a National Small Business Week.

Q.4. If the "sufficient number/lowest reasonable cost" formula is implemented, what will be the effect upon the number of small business set-asides? (Some commenters have stated they will be reduced by 50%.) Shouldn't that be determined before such a regulation is adopted?

A.4. The legal effect of Section 2732 of the Competition in Contracting Act of 1984 imposes the "sufficient number/lowest reasonable cost" formula as a matter of law. The effect on the number of set-asides by adoption of this formula is not a matter which can alter adoption of the formula. Although the precise effect is impossible to calculate, as a practical matter, it does not appear that adoption of the formula will reduce the number of small business set-asides. There may be a temporary reduction until agency contracting personnel become familiar with the revised regulations. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Small Business Act. The regulations will continue to require that contracting officers review acquisitions to determine if they can be set-aside and provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Q.5. Will adoption of the "lowest reasonable cost" standard give any big business the opportunity to veto or set-aside merely by saying it is interested in submitting an offer?

A.5. No. Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond than large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (P.L. 98-369, the Competition in Contracting Act of 1984, and P.L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business would be substantially lower than that proposed by small business would a set-aside be cancelled. This is the case under current law as well. The GAO has previously upheld cancellation of a set-aside procurement when information bids from large businesses indicated that the small business' price was unreasonable.

Q.6. How could any contracting officer be assured of having the "lowest reasonable cost" if he does not let large businesses bid?

A.6. The answer must be stated and understood in terms of the law that established the requirement. The CICA requires "full and open competition," which means all firms, large and small, must be allowed to compete. This provision would appear to negate small business set-asides. However, CICA very clearly intended not to preclude small busines set-asides. Thus, the Act recognized that full and open competition could exist when the competition is conducted solely among small businesses. However, to set a procurement aside, the contracting officer must reasonably foresee that competition conducted solely among small businesses is likely to result in the lowest reasonable cost.

Q.7. Under the proposed rule, if a large business comes forward and shows the contracting officer, through catalogue prices or otherwise, that its price would be substantially lower than the prices offered by small business, will the contracting officer not set-aside the procurement?

A.7. The procurement would probably not be set-aside. However, it is important to know the reason. It is not merely because a large business expressed interest in the procurement. It is because the contracting officer must make awards at "reasonable" prices. This is necessary to protect the Government from paying unreasonable costs. The fear is that with any rule of thumb, particularly one set at only two, contracting officers may apply it automatically and fail to ascertain that there is a real likelihood of bids in the lowest reasonable cost range. If the information supplied by the large business merely showed that it would be competitive with a sufficient number of small businesses that, in themselves, assure competition, the procurement would be set-aside. This response would also hold true under the "rule of two." This regulation also does not allow a bad business decision by the contracting officer. In addition to having "at least two" small businesses, the contracting officer must determine that the competition will result in reasonable prices. If confronted with the same information from the same large business (substantially lower price), the procurement would not be set-aside even under the "rule of two."

Q.8. What will OFPP do if the three regulatory agencies fail to issue the regulation for comment by March 23, 1986? Will it issue a draft policy letter for comment?

A.8. If the regulatory agencies fail to issue proposed regulations by March 23, 1986, OFPP will utilize its regulatory authority under the OFPP Act (41 USC 405) and, as outlined in OFPP Policy Letter 85-1, issue proposed regulations to be implemented in the Federal Acquisition Regulation for 30 days' public comment. We fully expect, however, that such action will not be necessary.

Q.9. Was this proposed regulation discussed, at least informally, with representatives of the small business community (i.e., SBA, SADBUs, appropriate Congressional staff) prior to issuance? If not, why not?

A.9. There was some limited internal discussion with executive branch agencies, including the SBA, prior to OFPP's decision to request the three agencies to

issue the rule. The rule has not yet been issued in final form. Interested parties will have a full opportunity to express their views on the proposed rule for the record.

Q.10 If the CICA is what caused OFPP to issue the proposed instruction, why did OFPP wait over 18 months to do so? Specifically, what triggered this action?

A.10. After its initial review of the provisions of CICA, OFPP did not conclude that a revision of the regulations addressing small business set-asides was required by the statute. However, after criticism that the rule of two had been included in the FAR without providing adequate public notice and opportunity for comment, OFPP published a Notice of Comment on October 12, 1984. 49 Fed. Reg. 40135. Many commenters noted that CICA, which was to become effective on April 1, 1985, evidenced Congress' concern with the continuing legality and appropriateness of the rule of two in set-aside situations. In December 1984, Congresman Jack Brooks and Frank Horton and Senators William Cohen and Carl Levin wrote to the regulatory agencies concerning the proposed FAR implementation of CICA. Among the matters which they pointed out was the fact that "rule of two," contained in FAR Part 19, was not appropriate in view of the language in Section 2732 of CICA regarding "sufficient number" and "lowest reasonable cost." They also stated that it was their intent, as co-sponsors of the legislation, to eliminate the "rule of two." The regulatory agencies disagreed, in a reaponse to the members in August 1985. The matter was raised again in December 1985, by a letter from Congressmen Jack Brooks and Frank Horton to Joseph Wright, Deputy Director of OMB, asserting their view that the "rule of two" was contrary to the CICA. After considering the comments on the October 1984 notice of comment and the provisions of CICA, OFPP decided to issue for public comment proposed regulations substituting the "sufficient number/lowest reasonable cost" formula in CICA for the "at least two/reasonable price" formula in the current FAR.

Q.11. Does the proposed approach apply to 8(a) firms — and the process by which they are awarded contracts? If not, why not?

A.11. The proposed approach will not apply to firms which are awarded subcontracts under Section 8(a) of the Small Business Act. It should be noted that Section 8(a) of the Small Business Act authorizes the Small Business Administration to enter into direct contracts with Federal agencies to provide goods and services by subcontracting the actual performance to small business firms which have been accepted into the business development program established by the Act. The regulations and procedures for 8(a) contracts and subcontracts are separate and apart from those governing small business set-asides and are unaffected by the OFPP notice.

Only if a firm which is included in the 8(a) program seeks direct procurements independent of the program, would it be subject to the standard FAR provisions, including the set-aside regulations.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 27 1986

MEMORANDUM FOR: JAMES C. MILLER III
JOSEPH R. WRIGHT, JR

FROM: David F. Baker, Acting Administrator, OFPP

SUBJECT: Activities for the Week of March 24

MAJOR ITEMS

1. Rule of Two: The 30 day period for DOD, GSA, and NASA to publish proposed regulations expired Monday. We were told by phone that they are refusing to comply. The promised letter to that effect was signed late yesterday. Pending Congressional contacts by Gordon Wheeler, we are preparing a Federal Register notice to move ahead with issuing the regulation under OFPP's regulatory authority.

EXECUTIVE OFFICE OF THE PRESIDENT
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WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

APR 3 1986

4/6/86

MEMORANDUM FOR THE DIRECTOR AND
DEPUTY DIRECTOR

FROM: David F. Baker, Acting Administrator, OFPP

SUBJECT: Activities for the Week of April 3rd

MAJOR ITEMS

- - -

2. Rule of Two: A letter to Jack Brooks was signed out Wednesday informing him of the fact that DoD, GSA and NASA refused to comply with our direction for regulatory elimination of the "rule of two". Barring action by Brooks to cause DoD, GSA and NASA to reverse their position, we are prepared to move forward with a proposed rule in the Federal Register under our regulatory authority.

C.—SELECTED OMB MEMORANDUM AND RELATED CORRESPONDENCE

July 19, 1984	CICA signed into law.
Nov 6, 1984	OFPP Memo to the File - Staff of Government Operations Committee calls OFPP to complain of publication of request for comments on"rule of two". Staff claims issued settled by CICA and sufficient number test should be adopted. (Exhibit A)
Dec 6, 1984	Memo from Don Sowle (OFPP Administrator to Joe Wright/Deputy Director OMB). A&E community engaged in concerted effort to repeal the "rule of two". A&Es are only about 4% of set-aside program and the "rule of two" is a legal way to implement the Small Business Act. (Exhibit B)
Jan 11, 1985	Memo from William Coleman (Counsel for OFPP) to William Mathis (Acting OFPP Administrator). Coleman gives his legal opinion that the "rule of two" is not inconsistent with CICA. (Exhibit C)
Jan 15, 1985	Memo from Mike Horowitz (General Counsel OMB) to Joe Wright. Horowitz gives his legal opinion that "rule of two" is inconsistent with CICA. (Exhibit D)
✓ April 3, 1985	Memo from William Mathis to Joe Wright. OFPP recommends that "rule of two" be maintained. Problems with set-asides related to size standards and definitions of small business. Meeting held with SBA's Frank Swain and other SBA officials. SBA admits to some problems and promises prompt action. (Exhibit E)
✓ April 18, 1985	Memo from William Mathis to Joe Wright. Meeting held with Bill Birkhofer, Associate Director, of the American Consulting Engineers Council (ACEC) -, the major A&E organization attacking the "rule of two". Birkhofer admits to OFPP, but not for "general dissemination", that the "rule of two" is not his problem. Real issue is size standards. Birkhofer admits that ACEC only used the "rule of two" to "get the Government's attention". Mathis complains about SBA slowness in correcting size standard issues. (Exhibit F)
✓ Mar 18, 1985	Memo for the record signed by William Mathis (OFPP Administrator) and Owen Birnbaum and William Coleman (Associate Administrators, OFPP). Contents of March 4, 1985 meeting in Joe Wright's office discussed. Former OMB General Counsel alleged to have made derisive and racially disparaging remarks concerning Federal employees holding positions in the offices of small and disadvantaged business utilization throughout the various agencies. (Exhibit G)

✓ Sept 19, 1985	Memo from Diane Weinstein (OMB office of General Counsel) to Joe Wright. Recommends using the new agency competition advocates to implement OMB's proposed set-aside test "in short, to pit the competition advocates against the small business reps.". Note also, memo indicates meeting with BoB Thompson and his counsel where OMB efforts to repeal the rule of two were discussed. Thompson represents a large A&E company. (Exhibit H)
Oct 1, 1985	Memo from Diane Weinstein to Joe Wright reciting alternatives for repealing the "rule of two". Handwritten note from Wright indicates choice of method subject to approval by Chairman Brooks. (Exhibit I)
✓ July 10, 1985	Memo from Bill Mathis to Joe Wright. Lower size standard for A&E should reduce opposition for "rule of two" by both Bill Birkhofer (American Consulting Engineers Council) and Chairman Brooks. (Exhibit J)
✓ Dec 7, 1985	Memo from Joe Wright to Gordon Wheeler (OMB Congressional Liaison). Wright directs Wheeler: "What I need is a quick note from Jack Brooks basically telling us to implement the provisions of CICA and get rid of the Rule of Two --it is simply too controversial to proceed without those instructions. Would you talk to Bill Jones about this?" Jones is General Counsel of the Government Operations Committee. (Exhibit K)
Dec 20, 1985	Letter from Chairman Brooks and Ranking Minority Member Frank Horton, Government Operations, urging repeal of the "rule of two" in order to comply with CICA. (Exhibit L)
Jan 16, 1986	Memo from Diane Weinstein. Recommends that OMB check with Government Operations staff before selecting the method to be used to repeal the "rule of two". (Exhibit M)
✓ Jan 28, 1986	Memo from Diane Weinstein to Jack Carley (General Counsel, OMB). Weinstein recommends that notice to the three regulatory agencies not be published in the Federal Register because such public notice "will serve only to build up preliminary agency and public pressure to 'blow' any rule of two amendment 'out of the water', before it is ever published as a proposed rule for comment. Bill (Coleman, OFPP) says OFPP 'likes to' publish everything they do in the Federal Register; but this is clearly unnecessary and, from Joe's (i.e. Wright's) and Brooks' points of view, may be counterproductive." (Exhibit N)
Jan 29, 1986	Diane Weinstein memo to Jack Carley. The three regulatory agencies not provided an opportunity to develop new set-aside language. OFPP warns OMB General Counsel's office

	"we don't want to 'jam this down their throats'." (Exhibit O)
Feb 21, 1986	OFPP memo to the three regulatory agencies directs that specific proposed regulatory language (repealing the "rule of two") be published for a thirty day comment period.
Mar 5, 1986	Letter from Joe Wright to Chairman Brooks. OMB agrees with the Chairman's interpretation of CICA. The three regulatory agencies are directed to make the change. Failure to do so will result in OMB invoking its authority. (Exhibit P)
Mar 10, 1986	Letter from Chairman Brooks to Joe Wright congratulating him on publishing the proposal to repeal the "rule of two". (Exhibit Q)
✓ Mar 18, 1986	Memo from Susan Tanaka (OMB employee who manages SBA's budget) to Carol Crawford (Tanaka's apparent supervisor). Rule of two controversy "is having an adverse impact on our legislative strategy for the Small Business Administration Budget proposal." Memo mentions that corrective legislative action may be taken on the "rule of two" but then adds: "OMB is already in the awkward situation of appearing to be speaking out of both sides of our mouth (OFPP appears to be trying to eliminate small business set-asides; the budget side is saying that we are not trying to harm the procurement program.) If OMB is forced to take a position on the 'corrective' action, we will either confirm an apparent anti-small business set-aide position, or we risk antagonizing Congressman Brooks." (Exhibit R)
Mar 21, 1986	Memo from Dave Baker (OFPP Acting Administrator) to the file. OFPP admits that its February 21, 1986 directive to the three regulatory agencies "may not comply fully with the letter of 85-1" which purports to implement the dispute resolution authority granted under section 6 of the OFPP Act. (Exhibit S)
✓ Mar 24, 1986	Memo from David Baker to Joe Wright. House Small Business Committee accused of "orchestrating" opposition in the small business community. OFPP again admits that the notice given to the three (3) regulatory agencies is in violation of Policy Letter 85-1. (Exhibit T)
Apr 18, 1986	Letter from Chairman Brooks and Ranking Minority Member Frank Horton to Joe Wright. OMB urged to live up to its promise of March 5, 1986 to use its own authority under section 6 of the OFPP Act to repeal the rule since the three (3) regulatory agencies have refused to do so. Exhibit V)

EXHIBIT A

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

NOV 6 1984

MEMORANDUM TO "RULE OF TWO" COMMENT FILE

FROM: BUD MARAIS

SUBJECT: Record of telephone comment from Jim Lewin on November 1, 1984

Jim Lewin called to ask why we published the "rule of two" in the Federal Register for comment. It is his view that the CICA settled the issue.

Jim pointed out the following section in the amendments to the OFPP Act, as well as the corresponding section in the conference report:

> (2) Section 16(1) of such Act (41 U.S.C. 414(1) is amended to read as follows:
> "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives "a sufficient number" of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".
>
> "The conference substitute amends Section 16(1) of the OFPP Act (executive agency responsibilities) to require the use of full and open competition in executive agency procurements of property and services. Language contained in this substitute requires agencies, when using competitive procedures, to establish policies, procedures, and practices necessary to ensure that a sufficient number of sealed bids or competitive proposals are received from responsible sources to fulfill the government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or services procured. This requirement applies to all agency procurements, including those made under set-aside programs."

He said that it was the conferee's view that the "rule of two" should be replaced by a concept of a sufficient number to fulfill requirements at the lowest reasonable cost. This represents a flexible standard that could vary from product to product or service to service. Each proposed set-aside should be evaluated using a standard evaluation that goes to heart of the issue - and that is, "will the resulting competition produce the lowest reasonable cost to the Government?" He feels that having a fixed number (2) standard does not do that.

EXHIBIT B

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

DEC 6 1984

MEMORANDUM FOR: JOE WRIGHT

FROM: Don Sowle Don

SUBJECT: Your note on the "Rule of Two" Regulations

The architect-engineer (A-E) community is currently engaged in a concerted effort to change the FAR "rule of two" which requires small business set-asides when there are two or more small businesses eligible to compete and reasonable prices will result. The A&E's are particularly concerned because over 97% of all A-E firms (some 30,000 in number) are classified by SBA as small businesses. Those concerned with the rule of two are interested in reducing the number of small business set-asides, but this is difficult because nearly the entire industry is classified as small and the competition is keen. The A&E's have been unsuccessful in convincing SBA to change the size standard so they are attacking the problem indirectly by zeroing-in on the "rule of two".

This "rule" was developed to implement the Small Business Act requirement that a fair proportion of total purchases be placed with small business concerns. The majority of the dollars go out for major systems for which small firms cannot compete. Therefore, to achieve a fair proportion of total sales, agencies must concentrate on those products and services where small businesses are competitive.

The "rule of two" is currently in the FAR because the procuring agencies, the SBA, the Small Business Committees, the GAO and the courts all are in agreement that it is an appropriate implementation of the Small Business Act. It also has been successful for many years in DOD.

Some facts you should know:

- We are requesting public comment because of complaints that the FAR process did not properly air this issue.

Joe, To put this in perspective, A+E are only about 4% of the total set-aside program.

D

EXHIBIT C

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JAN 11 1985

MEMORANDUM FOR: WILLIAM MATHIS

FROM: William S. Coleman, Jr.

SUBJECT: Rule of Two

You have requested our analysis of the impact of the Competition in Contracting Act of 1984 (CICA) (P.L. 98-369) on Subpart 19.502-2, "Total Set-Asides," of the Federal Acquisition Regulation (FAR).

Analysis

Subpart 19.502-2 of the FAR establishes the "rule of two" as the threshold criterion for determining whether to set-aside a procurement action for exclusive small business participation. The pertinent FAR language is as follows.

> The entire amount of an individual acquisition or class of acquisitions ... shall be set-aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible, small business concerns offering products of different small business concerns; and (b) awards will be made at reasonable prices. Total set-aside shall not be made unless such reasonable expectation exists.

The FAR provision constitutes the executive branch implementation of Section 15 of the Small Business Act (15 USC 644), which requires that contracting agencies ensure that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns.

Congress' intent, as expressed in these provisions of the Small Business Act, is confirmed in recent amendments to the Federal Property and Administrative Services Act (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Procurement Policy Act (OFPP), as set forth in the CICA and the Small Business and Federal Procurement Competition Enhancement Act of 1984 (P.L. 98-577).

Section 2301(c) of the ASPA, as amended by CICA, states as Congressional defense procurement policy:

> (c) Further, it is the policy of Congress that a fair proportion of the purchases and contracts entered into under this chapter be placed with small business concerns.

This same Congressional Policy is set forth in Section 302 of the FPASA.

Sections 303(a) of the FPASA and 2304(a)(1) of the ASPA, as amended by CICA, require agencies to obtain "full and open" competition through the use of competitive procedures in conducting a procurement for property or services. As defined in the OFPP Act, as amended by the CICA (41 USC 414), "full and open competition" means that "all responsible sources are permitted to submit sealed bids or competitive proposals in a procurement." However, under CICA and P.L. 98-577, agencies are expressly permitted, in sections 303(b)(2) of the FPASA and 2304(b)(2) of the ASPA, to fulfill the requirements relating to small business concerns by using procedures which restrict solicitations to small businesses, so long as all such businesses are allowed to compete. The Conference Report (H.R. 98-361, page 1424) explained that the conferees sought to give more precise recognition to set-aside programs authorized by statute and that, in "recognition" of the Congressional policy of providing assistance to small business, agencies are authorized to limit competition to small business concerns only. Moreover, in defining competitive procedures, Sections 309(b) of the FPASA and 10 USC 2302(2) were further amended by P.L. 98-577, to include:

> Procurements conducted in furtherance of Section 15 of the Small Business Act (15 USC 644), [are considered competitive] as long as all responsible business concerns that are entitled to submit offers for such procurements are permitted to compete;

The question has now been raised regarding the appropriateness of the FAR "rule of two" set-aside procedures in light of Section 16 (Executive Agency Responsibilities) of the OFPP Act, as amended by CICA. The pertinent parts of Section 16 now read:

> Sec. 16. To further achieve effective, efficient, and economic administration of the Federal procurement system, the head of each executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices --
>
> > "(1) increase the use of full and open competition in the procurement of property or services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured;".

Does the language in Section 16(1), which directs agencies to ensure receipt of "a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost ...," require that the provisions of the FAR 19-502.2 be revised accordingly?

It is clear that, by enacting this language, Congress intended agencies to apply a standard of lowest reasonable cost in procurement decisions, and the FAR should be revised accordingly. However, it is not clear that Congress intended that the

"sufficient number" language of the amendment eliminate or prohibit use of the "rule of two" as a threshold test in determining to set-aside a procurement for small business participation.

Under the current FAR procedures and the new FAR procedures which implement the CICA (effective April 1, 1985), the so-called "rule of two" is utilized as the threshold test in determining whether to set-aside procurements for small business. The contracting official must still apply the tests of "contractor responsibility" and "reasonable price" prior to executing a small business set-aside. Further, under the express language of the CICA, the contracting official must utilize competitive procedures among the small businesses.

The amendatory language of Section 16(1) was a conference substitute; the conference report includes a statement that: "This requirement applies to all agency procurements, including those made under set-aside programs." However, there is no reference in the legislative history that Congress intended to eliminate the "rule of two" as a regulatory procedure. In fact, Congress has specifically established a "rule of two" as the initial test for determining set-asides in small purchase procurements in Section 15 of the Small Business Act (15 USC 644(j)). Subsection 221(j) of P.L. 95-507 sets forth the following provisions:

> (j) Small purchase procedures
>
> Each contract for the procurement of goods and services which has an anticipated value of less than $10,000 and which is subject to small purchase procedures shall be reserved exclusively for small business concerns unless the contracting officer is unable to obtain offers from two or more small business concerns that are competitive with market prices and in terms of quality and delivery of the goods or services being purchased. In utilizing small purchase procedures, contracting officers shall, wherever circumstances permit, choose a method of payment which minimizes paperwork and facilitates prompt payment to contractor.

Although CICA directs improvement and simplification of small purchase procedures, the above provision of the Small Business Act has not been changed.

Conclusion

As indicated above, Congress has recognized the use of the "rule of two" in certain circumstances as the threshold test for initiating a set-aside. There are other situations in which the guidance is less clear, such as in the "sufficient number" language of Section 16 of the OFPP Act.

It appears, therefore, that the appropriate action under these circumstances would be to establish regulatory provisions which permit discretion by agencies to make set-aside determinations. Such discretion would not affect set-asides for small purchases under 15 USC 644(j), but would permit agency discretion in determining whether to set-aside after considering all pertinent factors; i.e., the nature of the requirement, the marketplace, ability to obtain the lowest reasonable cost, and the emphasis on carrying out the requirements of the small business statutes.

EXHIBIT D

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM

January 15, 1985

Mike – Go over this w/ JMS. ½ hr.

TO: Joe Wright

FROM: Mike Horowitz MH

RE: Rule of Two

1. This opinion concerns the legality of the "rule of two" now applied in set-aside decisions under new FAR 19.502-2.

2. Following my examination of the statute and its legislative history, I fully concur in the Brooks-Horton-Cohen-Levin view of the law. It is, accordingly, my opinion that the rule of two is inconsistent with the new standard enacted by the Competition in Contracting Act of 1984 (CICA), Title VII of the Deficit Reduction Act of 1984, P.L. 98-369. Consequently, I propose revising the offending FAR, not only to incorporate the "sufficient number of bids" standard established by CICA, but also, equally importantly, to ensure that these bids will result in awards at the "lowest reasonable cost," the second prong of the new CICA standard.

3. The Small Business Act (15 USC 644) authorizes the use of set-aside procurement for small businesses when it is determined to be (1) in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) in the interest of war or national defense programs, (3) in the interest of assuring that "a fair proportion of total purchases and contracts for property and services for the Government are placed in small business concerns" or (4) in assuring that "a fair proportion of the total sales of Government property be made to small business concerns."

4. FAR 19.502-2 was included in the comprehensive revisions to the FARs published in September, 1983, effective on April 1, 1984. Another set of revisions, purportedly incorporating the changes required by CICA, was published for comment on October 1, 1984 and submitted to the printer on December 1, 1984.

5. FAR 19.502-2 (which is not modified by the latest revision) implements Section 15 of the Small Business Act by providing that an individual acquisition or class of acquisitions "shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be

made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists." (Emphasis added.) Partial set-asides are also made subject to this standard.

6. On March 14, 1984 Congressman Brooks wrote to the Director complaining that the "rule of two" set-aside provisions in the final FAR 19.502-2 rule (1) were not included in the version that went out for public comment and (2) violate the law.

7. Don Sowle's May 30, 1984 response to Brooks understandably focused almost exclusively on whether the FAR properly implements the Small Business Act, contending that the "issue is not the method of determining the existence of adequate competition among small businesses" but, rather, the propriety of set-asides, which he felt had been resolved by Congress in the Small Business Act in favor of "non-procurement related public policies (socio-economic goals)."

8. CICA, Title VII of the Deficit Reduction Act of 1984, contains several provisions relating to competition in procurement, amending both the Federal Property and Administrative Services Act of 1949 (FPASA), the Armed Services Procurement Act (ASPA), and the Office of Federal Property Procurement Act (OFPPA). The CICA amendment to Section 16 of the OFPPA was a conference committee substitute. It mandates that executive agencies increase the use of "full and open competition" in procurement by "establishing ... procedures ... that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements ... at the lowest reasonable cost considering the nature of the property or service procured." (Emphasis added.) The conference report explains that this language is applicable when agencies are "using competitive procedures" and that the requirement "applies to all agency procurements, including those made under set-aside programs." (Note that old FPR 1-1.706-5 permitted total set asides under a "sufficient number" standard.)

9. It is my opinion that the CICA amendment to Section 16 of the OFPPA requires that the "rule of two" in the FAR set-aside regulations be replaced by a "sufficient number of bids" standard and that the "at reasonable prices" standard be changed to CICA's "lowest reasonable cost" test. In some circumstances full and open competition (the lowest reasonable cost) may be assumed on the basis of only two bids. However, the crucial test is competitiveness, not, as is the case with a rule of two, the lowest possible number.

10. Both OMB and OFPP have authority to ensure that the CICA changes are implemented in the revised FARs. Section 6(a) of the OFPPA vests in the Administrator of OFPP the "overall direction of procurement policy and leadership in the development of procurement systems of executive agencies" and, as a result of

the 1983 amendments restoring OFPP's regulatory authority, is authorized to "prescribe Government-wide procurement policies which shall be implemented in the single system of Government-wide procurement regulations...." Section 405 of Title 41, U.S. Code, gives the Administrator the authority, and directs him, "to promulgate a single, simplified, uniform Federal procurement regulation and to establish procedures for insuring compliance with such provisions by all Federal agencies." In addition, Section 6(b) permits the Administrator to prescribe Government-wide regulations when DoD, NASA and GSA are "unable to agree on or fail to issue Government-wide regulations ... in a timely manner." Finally, and most importantly, in Section 6(f) of the OFPPA, the Director of OMB is given ultimate oversight authority over agency procurement regulations, being empowered to "deny the promulgation of or rescind any Government-wide regulation or final rule or regulation of any executive agency relating to procurement if the Administrator determines that such rule or regulation is inconsistent with the policies set forth in section 401 of [the Act] or any policies, regulations, or procedures issued pursuant to [Section 6(a) of the Act]." The section 401 policies include "promoting full and open competition" and "establishing ... procedures ... which will provide ... property and services ... at the lowest reasonable cost." Section 6(a) of the Act, described above, vests in the Administrator the overall direction of procurement policy. In short, OFPP has regulatory authority in the event, as with the rule of two, of agency disagreement, as well as when a regulation is inconsistent with OFPP's policies -- such as that of full and fair competition, cited both in Section 401 and in the CICA amendment to Section 16.

11. I am informed that many of the changes which the GAO/Brooks letter found to be required by CICA have not been made and will not appear in the FAR revision which is now at the printers - purportedly because the recommended changes were not received in time to permit the FAR regulations to be in place and ready for implementation on April 1, 1984, the effective date of CICA.

12. In light of the above, I am directing my staff to work with OFPP to develop revisions, not only to the "rule of two" FAR provisions, but also, as necessary to properly implement CICA, to the other FAR provisions discussed in the Brooks/GAO letter. I am asking Diane Weinstein of my staff to come up with a proposed revision to FAR 19-502-2 within the next 10 days.

cc: Arlene Triplett
Bill Mathis

EXHIBIT E

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

APR 3 1985

MEMORANDUM THRU: ARLENE TRIPLETT A see note

TO: JOSEPH WRIGHT
GW

FROM: WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two — A – Setasides [illegible] again on FAR. AT. BW + MN.

By its Federal Register notice of October 12, 1984, OFPP solicited views on the "Rule of At Least Two" as set forth in Part 19 of the Federal Acquisition Regulation (FAR). The October 1984 publication resulted from criticism that this provision in the FAR had not been publicized and available for public comment in the FAR process.

OFPP has now completed its analysis of comments received in response to the Federal Register notice and needs your advice and guidance on developing OMB's position on this matter. In response to the notice we received 199 comments, of which seventy-two (72) supported the rule and 127 opposed it.*

a. 72 comments supporting the rule: Of the private sector comments almost all were from small and minority businesses. Generally, these comments noted that prior to the rule contracting officers could, and did, avoid making set-asides under the subjective "sufficient number" standard. Further, that the set-aside program was a critical element in the Government's small business program and that the survival of small and minority businesses was at stake.

b. 127 comments opposing the rule: Of the private sector comments almost all were from what appeared to be large companies or trade associations.

Many architect/engineer or construction companies commented in opposition to the rule. Many comments combined specific opposition to the rule with general criticism of the small business set-aside program itself.

Among the arguments contained in the "opposing" comments were that the rule is: Inconsistent with the new standard of "sufficient number" set forth in the 1984 Competition in Contracting Act (CICA); does not afford the contracting officer sufficient discretion in initiating a set-aside; has led, in certain industries, to disproportionate shares going to small business, etc. As noted, some of the comments were directed not against the rule but related to shortcomings in the actual operation of the set-aside program itself.

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*These figures are necessarily approximations. In some instances, numerous "offices" or "divisions" of a parent company sent in separate letters, largely identical. Some letters both "supported" and "criticized" the rule. Some criticized the set-aside program rather than the rule. All of this made precise "counting" very difficult. On balance, however, it is fair to say that 72 comments supported the rule and 127 opposed it.

Because several of these arguments appeared to have merit, we met with Frank Swain and other SBA officials. We advised SBA of our concern that a small company could apparently receive an award under a set-aside and then subcontract an inordinate percentage to a large business. Swain acknowledged SBA has no procedure in place to prevent this and promised prompt action. We also recommended that SBA investigate the possibility of "tiering" set-asides in A-E (construction) and other controversial areas. (For example, on a proposed procurement of, say, under $150,000 only firms with gross receipts of under $ x million could bid; on a procurement of $300,000 only firms with receipts of under $ y million could bid; and on procurements over a certain amount there would be no set-aside). Finally, we noted the anomaly of a small or a minority firm receiving a contract in a value greater than its size standard. SBA (Swain) will report back to us on these issues by the end of the month.

Secretary Taft, we understand, has a continuing and abiding interest in this matter. DOD (Taft) says it likes the rule and needs it.

The FAR staff has issued its interim implementation of CICA. The implementation does not address the issue of the rule.

The OFPP recommendation is to maintain the status quo and retain the rule. Our recommendation is based on the following: (1) The rule is a critical element in the small business set-aside program which, in turn, is a mainstay of the entire small business program. (2) The small business community, as well as the minority business community, is solidly behind the rule. (3) The FAR implementation is consistent with the CICA requirement for agency procedures to assure receipt of a "sufficient number of sealed bids or competitive proposals" with awards at the "lowest reasonable cost." (The set-aside program, incidentally, was firmly endorsed by Mr. Stockman in his recent testimony before the Senate Small Business Committee. Also, a vigorous small business community helps to keep large business more competitive.) (4) Almost all the agencies (not just DOD) support the rule. DOD formally instituted the rule in 1979 and Navy has used it for more than 20 years. (5) Deficiencies and shortcomings of the set-aside program, itself, can be remedied along the lines of our recent conversation with Swain, et. al. at SBA.

TO OFPP:

☒ See me

☐ Keep the FAR as is

☐ Use compromise language in my memo to Arlene Triplett of March 6, 1985

☐ Eliminate rule on the basis of Mike Howowitz's legal memorandum of Jan. 15, 1985

cc:
Mike Horowitz

EXHIBIT F

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL PROCUREMENT POLICY

APR 18 1985

MEMORANDUM THRU: ARLENE TRIPLETT

TO: JOSEPH WRIGHT

FROM: Bill WILLIAM E. MATHIS, ACTING ADMINISTRATOR

SUBJECT: Rule of At Least Two

After our meeting last Friday I moved to implement your suggestions on amending FAR 19.505-2, Total Set-Asides Provision (TSAP) re the "Rule of At Least Two."

First, Owen Birnbaum and I met with a staff member of the Senate Small Business Committee authorized to speak for Bob Dotchin, the Staff Director. The representative, Bill Montalto, was receptive to our suggestions that: (1) A&E procurements be tiered to "marry" the size of competing A&E firms with the size of the procurement (see our memo to you of April 3, 1985); (2) Prevent excessive subcontracting by small firms receiving awards under small business set-asides; (3) Carefully examine the anomaly of awards to a small or minority company in an amount greater than its size standard. He was also impressed with our plans to revise the FAR, discussed in detail below, to stress more selective set-aside procedures.

Second, we met with Bill Birkhofer, Associate Director, of the American Consulting Engineers Council (ACEC). He, also, was receptive to the proposals set forth in the preceding paragraph. We discussed with Birkhofer the TSAP ("Rule of at Least Two") in great detail. We agreed in principle, and even in some detail, on an amendment to the TSAP (FAR 19.502.2) to caution contracting officers that they: (1) should not apply the set-aside procedures mechanically or unthinkingly; (2) should consider the Government's need for high-quality items, particularly in high-tech areas; and (3) must follow the CICA requirement for receipt of a "sufficient number" of bids from responsible sources to fulfill the Government's requirements at the lowest reasonable cost.

Birkhofer admitted to us, quite candidly but not for general dissemination, that the "Rule of at Least Two" was not his problem but that he used it to "get the Government's attention." His problem, frankly stated, is SBA's unreasonably high size standard and his frustration since 1981 in getting the standard lowered. In my opinion, the standard of $7.5 million of sales averaged over a three year period is too high and should probably be set at $2,000,000. I will be pleased to demonstrate the basis for that judgment.

I am not happy at the slow pace at which SBA is moving on the matters we discussed with Frank Swain, Don Young, et.al. almost a month ago. I prefer to move in concert with them but am prepared to proceed without them, if necessary.

EXHIBIT G

Mr. Coleman

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

March 18, 1985

MEMORANDUM FOR THE RECORD

On Monday, March 4, 1985, the undersigned met with Joe Wright, Arlene Triplett, Mike Horowitz, and Diane Weinstein on the Rule of Two. Shortly after the meeting began it was apparent that the topic of conversation (about which we had not been fully informed prior to the meeting) was Mike Horowitz' memorandum to Joe Wright of January 15, 1985 in which he concluded that: "The CICA amendment to Section 16 of the OFPP Act requires that the 'rule of two' in the FAR set-aside regulations be replaced by a 'sufficient number of bids' standard and that the 'reasonable price' standard be changed to CICA's 'lowest reasonable cost' text."

Mr. Horowitz seemed particularly disturbed that OFPP was questioning his legal judgment and was not moving promptly to have the necessary FAR changes made to replace the "at least two" language with the "sufficient number" language he deemed required by CICA. The OFPP representatives then called to Mr. Horowitz' attention the following: 1) The language he relied on in new Section 16(1) of the OFPP Act (inserted by CICA) had to do with the receipt of bid and proposals once an invitation had been issued; 2) CICA itself stated that the sealed bids procedure is to "be used if there is a reasonable expectation of receiving more than one sealed bid" (emphasis added); and 3) both CICA and PL 98-577 specifically recognize small business set-asides as a competitive procedure provided only all eligible small business sources may bid. It was also pointed out to Mr. Horowitz that Congress, in Section 221(j) of PL 95-507, recognized the adequacy for purposes of competition of "at least two" small businesses for a set-aside of small purchases.

After a short while, Joe Wright suggested that we leave the legal question and that OFPP explain to him why, on a policy basis, the rule of two was necessary. Owen Birnbaum explained that the rule had been instituted by DOD in 1979 because its experience had shown that contracting officers were using (or misusing) the imprecise "sufficient number test" to avoid making set-asides. (It was also pointed out that DOD was not particularly known as a friend of small business.) DOD's

experience had shown that the rule was necessary to have an effective set-aside program and that the set- aside program was the "heart" of the small business procurement program. Finally, it was noted that the agencies had annual goals imposed upon them by virtue of Section 221 of PL 95-507 and that the set-aside program was a critical factor in meeting these goals.

Mr. Horowitz seemed to become increasingly irritated with the explanations offered by the OFPP representatives. In the course of his criticisms of the small business and small disadvantaged business programs, he constantly referred to the small business and small disadvantaged business officials as "small business junkies," "OSDBU junkies," and "minority business junkies". It was explained to him that these officials to whom he referred as "junkies" were persons holding positions established by statute (PL 95-507). This made little or no impression upon him, and at one point he appealed to the OFPP staff to "help him get rid of these people" (the OSDBU officials). Mr. Horowitz also made reference to the DOD OSDBU official as "that woman who is giving Will Taft a bad time".

Mike Horowitz complained to Joe Wright about the Federal Government's small business and small disadvantaged business programs and made disparaging remarks about the SADBU officials in government agencies. On at least one occasion, Mr. Horowitz pronounced the acronyms SADBU and OSDBU in a highly derisive manner, which one could interpret as an attempt to effect a black accent.

Toward the end of the meeting, Joe Wright stated that he owed a return call to Mr. Taft who had called earlier to request no final action be taken on the rule of two until DOD had made its case on behalf of the rule. Mention was also made of having this matter go to the Cabinet Council on Management and Administration, but this discussion seemed inconclusive.

The meeting ended with Mike Horowitz' request to Joe Wright that "we political people" (meaning Joe Wright, Mike Horowitz and Arlene Triplett) "meet alone to decide this matter."

William E. Mathis

William E. Mathis

Owen Birnbaum

William S. Coleman Jr.

EXHIBIT H

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM September 19, 1985

TO: Joe Wright

FROM: Diane Weinstein

SUBJECT: Rule of Two

As you requested, I met with Bob Thompson yesterday on the Rule of Two Circular idea.

He and I basically agree on content -- what DoD, NASA and GSA should be instructed to put in revised uniform FAR regulations in order to fully implement the CICA competition requirements for small business set asides. To his latest suggestions, I added the idea of using the newly created "advocates for competition" to monitor proper application of the new competition standard (in short, to pit the competition advocates against the small business reps). OK

However, I have serious reservations about the form of Bob's proposal -- to use an OMB Circular as the implementing vehicle. (Actually, the Circular would not be self-implementing; the three procurement agencies would still have to take steps -- including following the new OFPP Act 30 day notice and comment procedures -- to implement the Circular in the FAR.)

The OFPP Act gives the Administrator (not the Director of OMB, as Thompson's Counsel, Karen Hastie Williams, the former OFPP Administrator, maintains) the authority to prescribe FAR regulations when -- as here -- DoD, NASA and GSA disagree or, more to the point, fail to issue regulations in a timely manner. However, OFPP's prescriptive regulatory authority has not to date been exercised and I question the advisability of making this critical maiden effort over the Rule of Two issue. Agree

The Director's regulatory power is currently limited to rescinding or denying promulgation of regulations which the OFPP Administrator determines are inconsistent with the Act's policies. This authority, although it could theoretically be used to repeal the current Rule of Two, would not get us a new set-aside rule.

Therefore, we should consider other alternatives to the Circular (or to OFPP's use of its new regulatory authority) for implementing the CICA set-aside requirements. OFPP could be helpful on this -- e.g., by proposing other alternatives or, even better, by pressuring GSA/NASA/DoD to do the right thing, without waiting for formal OMB/OFPP direction. However, the prospects of OFPP succeeding with the latter approach appear bleak?

I will shortly prepare for you a comprehensive list of implementing options.

OK

EXHIBIT I

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM October 1, 1985

TO: Joe Wright

FROM: Diane Weinstein DW

RE: Rule of Two

Here are some alternatives for requiring FAR implementation of the Rule of Two changes required by CICA.

I. Formal OMB Action -- Most of these actions would be undertaken pursuant to OMB's general management authority, not under the OFPP Act, which limits the Director's authority to rescinding or denying promulgation of regulations that the OFPP Administrator determines are inconsistent with the OFPP Act's policies. Rescission of the Rule of Two is not enough; it must be replaced.

1. OMB Circular. An OMB circular is generally defined as a directive communicating significant governmentwide policy of a continuing nature.

Since changing the Rule of Two as suggested in the proposed circular would be a one-shot deal, this seems inappropriate. Also, circulars generally do not deal with such narrow issues as the Rule of Two. Finally, although we are not legally obligated to do so -- either under the APA or the Federal Register Act -- since 1978, new OMB circulars have been published for notice and comment. Thus, two publications would be required, first of the circular and again (as required by new Section 18 of the OFPP Act) for 30 days' notice and comment at the point the procurement agencies propose the required FAR revisions implementing the circular. In short, this alternative seems clumsy and will needlessly attract attention twice. Further, it may resuscitate unwanted (remember A-122) questions regarding the legal status of OMB circulars.

Diane — lets go Circular and get [illegible] with Broad appeal

2. OMB Bulletin. An OMB bulletin is more appropriate than a circular in that it is designed to communicate transitory guidance to the agencies, or guidance that requires only one-time action. It would not have to be published. However, like a circular, it also would not be

self-implementing. The procurement agencies would still have to publish the FAR changes for 30 day notice and comment as required for all procurement regulations by the OFPP Act.

II. Formal OFPP Action.

1. OFPP Regulations. The most "clean" and direct way to implement the FAR Rule of Two changes required by CICA would be for OFPP to directly exercise its own regulatory authority under the 1983 reauthorization. The Act authorizes the Administrator to prescribe FAR regulations when DoD, NASA and GSA disagree (as they now at least arguably do, since the military agencies are now required by Cognress to use a dollar threshhold for initiating set asides) or when they fail to issue regulations in a timely manner. The latter rationale seems most appropriate, given the inordinate delay in implementing Brooks' desired CICA changes. (The long-awaited GSA/DoD/NASA response to the Brooks/Cohen/-Levin/-Horton letter on CICA contained only the following statement on "Rule of Two": "We do not interpret the "Rule of Two" to be in conflict with CICA. Use of the rule contemplates full and open competition after a set aside decision has been made.")

However, as everyone seems to agree, the Rule of Two is not the best vehicle for this maiden OFPP effort to exercise its regulatory authority.

2. OFPP Policy Letter. Like the OMB Circular, an OFPP policy letter is a directive of continuing nature, which is generally published and is not self-implementing (new FAR regulations would still be required to be published for comment, etc.).

3. OFPP Bulletin. Although there is currently no such creature, one could theoretically be created, by analogy to the OMB Bulletin, to deal with one-time action such as this. This would not have to be published.

III. Informal OMB/OFPP Action.

The best solution, although by no means guaranteed of success, may be for OFPP and OMB to make a concerted effort (carrying but not wielding the big stick of OFPP's prescriptive regulatory authority) to convince the procurement agencies of the need to revise the FAR regulations on their own. This will require the devotion (not the mere "assignment") of OFPP staff to this cause and may have to await appointment of a new Administrator for maximum effectiveness.

Recommendation:

I recommend option III -- that we lean on OFPP to, in turn, lean hard (in writing, if necessary) on the procurement agencies to do this without forcing us to initiate formal OFPP/OMB action. This can be an opportunity for them to show (as they may soon very much want to -- once a new authoritative regime is in place at OFPP) that the process can work to accommodate OFPP "policy direction" without formal OFPP regulatory action or public confrontation.

Alternatively, and if the foregoing approach doesn't work soon, (or appear likely to work at all) an "OFPP Bulletin," as in option II.3., may serve to let the FAR agencies know exactly what is wanted and may be a neat -- and graphic -- first step putting them on notice that more formal unilateral OFPP prescriptive regulatory action is being considered.

EXHIBIT J

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

JUL 10 1985

Horowitz —
Comments
ASAP please.
Lee

MEMORANDUM FOR JOE WRIGHT

FROM: Bill Mathis Bill

SUBJECT: Small Business Size Standards

You asked about the effect of a possible reduction from $7.5 to $1.5 million in the size standard for construction-related A/E services and its relationship to the Rule of At Least Two.

Since Bill Birkhofer (ACEC) earlier indicated to us that his real problem was the size standard not the "rule", the change should be very helpful in reducing his (and Congressman Brooks') opposition to the rule. SBA has been cooperative in action to lower the standard. However, we still have not reached an agreement with Birkhofer (and Chairman Brooks) on language to be added to the FAR regarding application of the rule to A/E procurement.

EXHIBIT K

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

December 7, 1985

MEMORANDUM FOR GORDON WHEELER

FROM: JOE WRIGHT

SUBJECT: Rule of Two

Gordon -- as you know we have been going over this "Rule of Two" regulation for the last year and a half. Jack Brooks told me (and Frank Horton concurred) that it was their intent to get rid of the Rule of Two in CICA. OFPP feels very strongly that this would be the wrong move but their arguments simply don't have much credibility.

What I need is a quick note from Jack Brooks basically telling us to implement the provisions of CICA and get rid of the Rule of Two -- it is simply too controversial to proceed without those instructions. Would you talk to Bill Jones about this? Thanks.

cc: Diane Weinstein

EXHIBIT L

NINETY-NINTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT OPERATIONS

2157 Rayburn House Office Building

Washington, DC 20515

15 DEC24

December 20, 1985

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

As you know, we strongly believe that the Federal procurement process should be made more competitive, so that agencies will receive the best appropriate goods and services at the lowest possible overall cost. The Competition in Contracting Act, enacted last year on our recommendation in Public Law 98-369, makes full and open competition the standard for Federal procurements.

A number of statutes and regulations, however, still interfere with appropriate implementation of this Act, and consequently deprive our citizens of the opportunity to get the best buys for their tax dollars. Prominent among these regulations is the "rule of two," which permits agency officials to set a contract aside for award only to a small business whenever the officials think that two or more small firms might want to perform the work. Once a contract is set aside, any efficient company which is larger than the size established under Small Business Administration regulations may not be awarded that contract--even if it can do the work better, and at a lower price, than a small firm can.

This "rule of two" was inserted into the Federal Acquisition Regulation without public comment prior to enactment of the Competition Act. It is clearly inconsistent with the spirit of that law. Furthermore, it has no basis in statute. In fact, in the same year that Congress approved the Act, the House of Representatives, at the urging of numerous committee chairmen and ranking minority members, chose not to consider a bill whose principal provision would have given statutory authority to the rule.

When the Competition Act became effective last April, the FAR should have been amended to bring the "rule of two" into conformity with the Act. Despite the inconsistency between the Act and the rule, and despite the numerous public comments which the Office of Federal Procurement Policy received in opposition to the rule at the end of 1984, the FAR still has not been amended.

We urge you and the OFPP to replace the rule with regulations which comply with the Competition Act and therefore further an objective which you and we share: achieving better buys through increased competition in Federal procurement.

Sincerely,

Jack Brooks　　Frank

JACK BROOKS
Chairman

FRANK HORTON
Ranking Minority Member

22058

EXHIBIT M

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM January 16, 1986

TO: Joe Wright

FROM: Diane Weinstein

SUBJECT: Rule of Two

I met with David Baker ~~and Bud~~ Maraist yesterday. They discussed two alternatives to my "proposed rule" for resolving the "rule of two" problem. They were unsure whether you were familiar with these proposals.

First, they proposed the "Policy Letter" solution alluded to in Owen Birnbaum's proposed response to the Brooks-Horton letter. This is circulating for internal clearance now. This draft "Policy Letter 86-1" (attached) merely sets out the "policy" that contracting officers shall be "made aware" (1) of the terms of the CICA standard and (2) that "there may be instances where the receipt and consideration of an absolute minimum of two offers may not be adequate, especially where one of the sources is marginally responsible." They say you told Birnbaum/Mathis you were willing to consider a solution along these lines. However, ~~as Baker and Maraist admitted, this is~~ very unlikely to be satisfactory to Brooks et al.

?? I DON'T REMEMBER THIS AT ALL.

Their "fall-back" solution is a "Notice" (attached) to DoD, GSA and NASA, much like the "OFPP Bulletin" I suggested this fall. The Notice would give the three agencies a deadline (unspecified) to amend the FAR to implement CICA (using the language identical to that in the proposed rule I sent you last week).

You may recall that when we had first proposed the OFPP Bulletin as a means of giving the three procurement agencies an opportunity to change the FAR themselves, Mathis and Birnbaum argued that, because the three agencies were so firmly opposed to changing the rule, this would be futile and a waste of time. I am now informed that this was merely a "straw" argument and that the Notice will clearly ~~inform the three agencies that OMB~~/OFPP is serious and is likely to provoke appropriate action. Also, ~~the Notice~~ follows OFPP's new (but in my mind, unnecessarily restrictive) procedures for determining when the agencies have failed to "timely" issue regs (the statutory predicate to OFPP's exercising its prescriptive regulatory authority) in OFPP's August Policy Letter 85-1.

You should decide -- (perhaps after Gordon checks with Brooks' staff) but before the letter to Brooks/Horton goes out -- which course you want to pursue:

1. Birnbaum Policy Letter 86-1
2. Notice to DoD/NASA/GSA or
3. Proposed rule issued by OMB/OFPP

c: Jack Carley

EXHIBIT N

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON D C 20503

MEMORANDUM

January 28, 1986

TO: Jack Carley

FROM: Diane Weinstein

SUBJECT: Rule of Two

I spoke with Bill Coleman of OFPP, who says you undertook to urge Joe to accept the "notice option."

Under this option OFPP would (1) notify the three procurement agencies (DoD, NASA and GSA), following the OFPP Policy Letter 85-1 procedures, (2) publish the notice in the Federal Register, and (3) give the three agencies 90 (or, if Joe objects, 60) days to publish the proposed rule for 30 (to 60) days' comment. Even without any additional delay by the three agencies, a final rule under these time frames could not be published for 90 (or up to 150) days.

I suggest we give the three agencies 30 days by which to publish the proposed rule for 30 days' comment (all that is required by the CICA amendment to the OFPP Act).

I also suggest that the notice to the three agencies not be published. Neither CICA nor OFPP Policy Letter 85-1 requires publication of a "notice" to the three agencies. Further, publishing the notice will serve only to build up preliminary agency and public pressure to "blow" any rule of two amendment "out of the water," before it is ever published as a proposed rule for comment.

Bill says OFPP "likes to" publish everything they do in the Federal Register; but this is clearly unnecessary and, from Joe's and Brooks' points of view, may be counterproductive.

EXHIBIT O

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MEMORANDUM January 29, 1986

TO: Jack Carley

FROM: Diane Weinstein

SUBJECT: Rule of Two -- Follow up on Yesterday's Memo

Bill Coleman says OFPP is willing to forego publication of the notice to the three agencies, but insists that they should be given 60 days to decide whether to publish the proposed rule (for 30 days' comment).

My fear, confirmed by Coleman's off-the-cuff comments, is that the three agencies will come back in 60 days with a substantially different proposed rule (as Coleman says, they can't be expected to just publish it in the form we asked). Then we will be at square one again (only with 60 days passed and still no proposed rule), effectively negotiating with the three agencies, e.g., about whether their proposal is "substantially" like ours and, even more fundamentally, when (or even whether) to actually propose rescinding the rule of two.

Coleman says they're not trying to stall: (1) the agencies simply need the time to "develop" a proposed rule, and (2) for diplomatic and precedential reasons (we have to keep up good relations with these agencies), we don't want to "jam this down their throats."

My responses are: (1) why do they need all this time if they're just making an up or down decision on whether to publish the proposed rule substantially as we've drafted it (remember too, that this is not exactly a novel issue and that the agencies have long been on notice (albeit informally) that something is afoot re changing the rule of two) and (2) giving them 30 days puts the burden on them to ask for, and, most importantly, explain why they need, more time. If the reason is that they're substantially redoing (i.e., gutting) the proposal, we can then negotiate, or go ahead and publish the rule ourselves, having lost only 30 days in carrying out Joe's promise to Brooks.

However, all this discussion may be mooted if Joe decides to go out directly with the proposed rule -- which he may just do out of frustration at the kind of continual bureaucratic bickering reflected by these tedious memos.

EXHIBIT P

Official file - OFPP/PL&L
PL&L Chron
DO Records - OMB Control #22058
Director's Chron
Legislative Affairs
General Counsel
Mr. Baker
Mrs. Weinstein
OFPP Reading File (2)
Mr. Coleman's Chron

GC:DWeinstein 2/10/86
Edited:WSColeman:tjah 2/21/86

MAR 0 5 1986

Honorable Jack Brooks
Chairman, Committee on
Government Operations
U. S. House of Representatives
Washington, DC 20515

Identical letter sent to:
Honorable Frank Horton
Ranking Minority Member

Dear Congressman Brooks:

This is in reply to your letter of December 20, 1985, on the Total Set-Aside Provisions (TSAP) or "rule of two" contained in the Federal Acquisition Regulation (FAR) 19.502-2.

The TSAP currently provide that an acquisition shall be set aside for exclusive small business participation if the contracting officer determines that "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns ... and (b) awards will be made at reasonable prices." (Emphasis added.)

As a result of public concern that FAR adoption of the current provision was done without sufficient opportunity for public comment, the Office of Federal Procurement Policy (OFPP), on October 12, 1984, solicited the views of all interested persons on the "rule of two." More than 200 comments were received, of which approximately 65 percent opposed the provision.

Since then, as you note, the continuing validity of the "rule of two" was brought into question by the Competition in Contracting Act (CICA), which established competition principles based on the standard of "a sufficient number" of bids to result in the "lowest reasonable cost" to the Government.

After reviewing the legislative history of CICA and the comments solicited by the 1984 notice, OFPP has determined that the decision to set-aside an acquisition which exceeds $25,000 for exclusive participation by small business must be based upon the standard of competition established therein. Accordingly, we have notified the three procurement agencies that they must publish for comment a proposed rule revoking the rule of two. Such publication must occur within 30 days to be considered "timely" and avoid OFPP's directly exercising its independent statutory authority to prescribe this procurement regulation.

We trust this satisfactorily responds to your letter.

Sincerely,

Joe Wright

Joseph R. Wright, Jr.
Deputy Director

EXHIBIT Q

NINETY-NINTH CONGRESS

Congress of the United States
House of Representatives
COMMITTEE ON GOVERNMENT OPERATIONS
2157 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

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MAJORITY—225-5051
MINORITY—225-5074

MAR 17 1986

Wright
OFPP

March 10, 1986

To Dean [illegible]
F/F.6

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

Thank you for your letter of March 5, 1986, notifying the Committee of OMB's decision to revoke the "Rule of Two". As you correctly note in your letter, the Competition in Contracting Act of 1984 (CICA) establishes new competition standards which require agencies to obtain a sufficient number of bids to ensure that the government receives the lowest reasonable cost.

I congratulate you on your decision to require the procuring agencies to modify the Federal Acquisition Regulation (FAR) to conform to the requirements of CICA. I believe that this step will not only reduce the cost of the government's purchases, but will in the long run open up a greater share of the Federal market to small businesses.

With best wishes, I am

Sincerely,

Jack Brooks

JACK BROOKS
Chairman

1 [illegible]
2 cc to Curley

EXHIBIT R

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

March 18, 1986

MEMORANDUM FOR CAROL CRAWFORD

FROM: Susan Tanaka STanaka

SUBJECT: Small Business Procurement Set-Aside Controversy

The purpose of this memorandum is to provide you with information on a procurement issue that is creating concern among the small business community and is having an adverse impact on our legislative strategy for the Small Business Administration Budget proposal. No action on your part is required at this time. However, you may be questioned about this issue when you address small business groups.

Background

Over the past year, OMB, through the Office of Federal Procurement Policy (OFPP), the General Counsel, and the Deputy Director, has been engaged in discussions with the Government Operations and Government Affairs Committees of the House and Senate concerning implementation of the Competition in Contracting Act of 1984 (CICA). An issue of specific concern to House Committee Chairman Jack Brooks (D-TX) is the "rule of two," used in the Federal Acquisition Regulations (FAR) by Government procurement officers to decide whether or not a contract should be set-aside for small business bid. The "rule of two" means that if the procuring officer has a reasonable expectation that at least two or more small businesses are likely to offer bids at "reasonable" prices for a contract, the contract should be set-aside for exclusive bid by small businesses.

CICA states that procuring agencies must use procedures that assure that a "sufficient number" of bids are received so that the contract can be fulfilled at the "lowest reasonable cost." The Conference Report states that this requirement applies to procurements made under set-aside programs.

Lengthy discussions within OMB between OFPP, GC, and the Deputy Director took place on this issue. At the direction of the Deputy Director, OFPP issued a memorandum (Attachment A) on February 21 to the Department of Defense, NASA, and GSA (the largest procuring agencies) instructing them to revise their procurement regulations to conform with CICA and to publish the proposed rules for a 30-day comment period. The Congressional committees were notified of OFPP action on March 5 (Attachment B). TCJ staff learned of this issue through a Wall Street Journal article published on March 4 (Attachment C). The House Small Business Committee's reaction to OFPP's action is also attached (Attachment D).

Current Status

The small business procurement community is concerned that the revised procedures will effectively eliminate small business set-asides. They fear that procuring officers will feel that the only way to meet the CICA requirement is through open competition. The decision about what constitutes a "sufficient" number and the "lowest reasonable cost" would be left to each individual procurement officer. Since more than two bids are usually received (the average is 6 or 7 in some procuring agencies), SBA staff advise that a "rule of four" or some other definite number would be preferrable than an unspecified "sufficient" number and argue that the assumption should be made that this competition will assure the "lowest reasonable cost" requirement is being met.

OFPP staff believe that the small business concerns can be aired during the public comment period once the agencies have developed their revised rules and will be adequately addressed at that time.

TCJ staff do not have a substantive objection to the OFPP action, but are concerned about the lack of coordination and the timing. As you know, we are currently trying to convince the small business community that the budget proposal supports the small business procurement set-aside program and that even the proposal to eliminate the Procurement Center Representatives (PCRs) would not harm small business interests.

Congressman Dreier's (R-CA) staff have indicated that the PCRs will be restored in the SBA bill the Congressman introduces. This is a direct result of the OFPP action, and is an attempt to calm the fears of the small business community and to keep this issue from ruining the chances of our budget proposal. In addition, a legislative attempt to "correct" past Congressional action may be made to alter the lowest reasonable price provision as it applies to small business set-asides.

OMB is already in the awkward situation of appearing to be speaking out of both sides of our mouth (OFPP appears to be trying to eliminate small business set-asides; the budget side is saying that we are not trying to harm the procurement programs.) If OMB is forced to take a position on the "corrective" action, we will either confirm an apparent anti-small business set-aside position, or we risk antagonizing Congressman Brooks. In the meantime, in response to inquiries, TCJ staff are explaining that the OMB (OFPP) action is required by Congressional action.

TCJ staff will keep you informed about developments as they relate to our legislative strategy for the SBA proposal.

Attachments

EXHIBIT S

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 21 1986

MEMORANDUM FOR RECORD

FROM: David F. Baker, Acting Administrator

SUBJECT: Regulatory Agency Response: Rule-of-Two

I was contacted today by Eleanor Spector (DoD's Deputy Assistant Secretary for Acquisition) at 1:20 p.m. regarding the procurement regulatory agencies' response to our February 21st instruction regarding replacement of the rule-of-two by the "sufficient number" formula. In the conference call, Ms. Spector indicated that she was in the company of Patricia Szervo (GSA's Associate Administrator for Acquisition Policy), Dennis Trosch (DoD General Counsel). and Larry Rizzi (FAR Executive Secretariat).

Ms. Spector informed me that the agencies had concluded that they would not comply with our February 21st instruction because the instruction did not reflect the process delineated in OMB Policy Letter 85-1. Specifically, she read the sentence from paragraph 7 that states, "... When the Administrator considers that a particular OFPP FAR change is not being resolved in a timely manner, the Administrator, after consultation with DoD, GSA and NASA, shall give notice and specify a time in which a decision must be reached regarding issuance of regulations." Ms. Spector pointed out that there had been no consultation or indication by OFPP of our disagreement with the agencies' view, or any indication of what constituted timeliness regarding the reaching of a decision on this issue -- and that, therefore, the OFPP instruction was contrary to the process which had been set up for this purpose.

I explained that while our instruction may not comply fully with the letter of 85-1, it was, nonetheless, a valid exercise of OFPP authority and reflected the Administration's desires with regard to the rule-of-two matter. And, while we would be disappointed if the agencies chose not to comply with our instruction, we would take whatever action was appropriate to implement the Administration's wishes.

Prior to concluding the conversation, Ms. Spector also volunteered the information that DoD's SADBU representative was preparing a letter for the Secretary's signature to the Director of OMB taking issue with the substance of the policy and pointing out its possible deleterious effects on small business. She again emphasized that while she did not personally question the Administration's right to issue the policy or the substance of the policy, she did question the form in which we did issue the instruction.

Upon reflection, I called Ms. Spector back to request that the substance of the preceeding conversation be provided to us officially and in writing. She said she would do so. She also said this decision had been cleared with L. Hopkins of NASA prior to her calling me.

EXHIBIT T

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

OFFICE OF FEDERAL
PROCUREMENT
POLICY

MAR 24 1986

MEMORANDUM FOR JOSEPH WRIGHT, JR.

FROM: David

David F. Baker

SUBJECT: Rule of Two

This will provide background information for your meeting with the deputies of DoD, GSA and NASA, which I understand that Amanda is setting up (in accordance with your instructions) for tomorrow, Tuesday, March 25th.

- On February 21st, we instructed the three procurement regulatory agencies to issue for comment within 30 days a proposed regulation that would replace the "rule of two" with the "sufficient number" formula - for use by contracting officers in making small business set-aside determinations. (Our February 21st instruction is attached at Tab A.) Today was the deadline for the agencies to publish the instruction for comment.

- Last Friday, I was contacted by Eleanor Spector - the head of DoD's procurement policy office - who said that the three agencies had concluded that they would not comply with our instruction. She said that this noncompliance was not due to their opposition to the substance of the regulatory change - but to the fact that we had not followed the specific requirements of the OFPP Policy Letter 85-1 (which sets out the procedures for OFPP's involvement in the regulatory process.)

- She also said that she understands that DoD's small business advocate had prepared a letter for Weinberger's signature to Jim Miller outlining DoD's substantive opposition to the proposed policy change, and asking that it be withdrawn. The important point that I garnered from Spector's call is that the political level in the agencies has not yet grappled with this issue, only the professional procurement people. So there still should be time to influence Will Taft (DoD), Paul Trause (GSA) and Bill Graham (NASA). (A more complete account of my conversation with E. Spector is attached at Tab B).

- The reaction, incidentally, to our February 21st instruction has been fairly muted. Predictably, the House Small Business Committee is upset with the decision (See Tab C) and has begun to orchestrate opposition in the small business community to our proposed change. There have been multiple Congressional and press inquiries regarding our action - but our responses to those questions have been generally well received. (Enclosed at Tab D are questions and answers, jointly developed with Jack Cariey's staff, that describe the purpose of our February 21st instruction - and its likely effects. I suggest you may wish to read through these fairly carefully prior to your meeting with the three deputies.)

- The principal points which need to be made to the agency deputies, I believe, are these:

  (1) Our instruction to the agencies is clearly in accordance with, and required by, the Competition in Contracting Act of 1984 - which explicitly requires that the "sufficient number" formula be adopted. (The fact that we did not follow all the procedural requirements of our own Policy Letter is irrelevant and simply serves as a convenient excuse for the agencies not to act and, thus, avoid the heat generated by the small business community.)

  (2) The "sufficient number" formula is not new. A variation of it was used by the civil agencies prior to issuance of the FAR for many years - without any obvious deleterious effects on the small business set-aside program.

  (3) We are convinced that the effect of our proposed change will be minimal in terms of reducing the actual number of procurements set-aside for small businesses. Contracting officers simply will have a bit more discretion in making those set-aside decisions.

We will be pleased to discuss this matters further with you at your convenience.

Attachments

c: J. Carley
C. Dineen
C. Crawford

EXHIBIT V

NINETY-NINTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT OPERATIONS

2157 Rayburn House Office Building

Washington, DC 20515

April 18, 1986

The Honorable Joseph R. Wright, Jr.
Deputy Director
Office of Management and Budget
Washington, D.C. 20503

Dear Joe:

We very much appreciated your March 5 response to our letter which urged that the Federal Acquisition Regulation be amended to bring guidance for setting aside contracts for competition only among small businesses into conformity with the Competition in Contracting Act of 1984.

Your response stated that you had directed the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration to publish for comment a proposed rule which would replace the current "Rule of Two" with guidance which is consistent with the Competition Act. Further, you wrote, if those three agencies did not act within 30 days, the Office of Federal Procurement Policy would exercise its independent statutory authority to prescribe the appropriate regulation.

On April 2, you informed us that DOD, GSA, and NASA had arrogantly refused to publish the required regulatory change. We urge you now to fulfill your earlier commitment by having OFPP publish the proposed rule for comment under the authorities contained in Section 6 of P.L. 98-191, the Office of Federal Procurement Policy Act Amendments of 1983.

Sincerely,

Jack Brooks
JACK BROOKS
Chairman

Frank
FRANK HORTON
Ranking Minority Member

Information Paper on Rule of Two

Definition:	Contracting Officer is to set aside contract whenever there is a reasonable expectation that, (1) offers will be received from at least two responsible small business concerns; and, (2) awards will be made at reasonable prices.
When Adopted:	The rule of two was first used by the Navy in 1964, by the entire military in 1978, by NASA in 1982, and by all agencies since 1984.
Set Aside Awards:	In FY 1984, set asides were valued at $15.6 billion and represented nearly one-half of all prime contract awards to small business.
The Problem:	Memo dated February 21, 1986, from the Administrator of the Office of Federal Procurement Policy (which is part of OMB) required that the Department of Defense (DoD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA) publish for a 30 day comment period a proposed regulation that would be applicable to all military and civilian agencies. The regulation would: (1) repeal the rule of two; (2) prohibit a regular small business set aside unless the contracting officer determines before the contract is advertised that he/she will receive the lowest reasonable cost from a small business. In effect, any large business expressing a desire to compete for the award would preclude a set aside; (3) prohibit a class set-aside (i.e. for a class of items or services) unless the contracting officer provides a written determination that for each item being purchased small business will provide the lowest costs; and (4) prohibit a repetitive set aside unless the contracting officer provides a written determination reaffirming that small business will submit the lowest cost. Under existing regulations once an item is purchased under a set aside future purchases must also be set aside unless two or more small businesses are not expected to compete. DoD, NASA, and GSA have all refused to publish the OFPP memorandum because of their belief that the new Competition In Contracting Act does not require repeal of the rule of two. OMB has, however, published the repeal on May 22 under a legal authority allowing them to publish procurement regulations when DoD, NASA, and GSA do not act in a "timely" manner.
Effect:	The proposed regulation, if adopted, would likely destroy the set aside program. Small businesses will lose billions of dollars a year if the regulation should become effective.
Political Problems:	It must be kept in mind that the move to "kill" set asides was started by those industries adversely affected by high size standards. Since H.R. 1178 has been defeated, the considerable support we had for the bill will now likely advocate for the adoption of the new regulation. Since set asides cannot be "fixed" by reforming size standards, we can expect these individuals and organizations to attack the very concept of set asides.

Updated 3/27/86

PRIME CONTRACTS STATISTICS

($s ROUNDED TO NEXT HIGHEST BILLION)

DEPARTMENT OF DEFENSE

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
TOTAL DOD AWARDS	38.2	39.0	47.1	54.4	58.5	66.7	87.2	102.5	121.1	124.9	139.6
AWARDS TO SMALL BUSINESS	7.9	8.1	9.5	10.7	12.2	13.6	17.8	20.1	22.8	23.8	26.0
PERCENT TO SMALL BUSINESS	20.6	20.8	20.2	19.7	20.8	20.4	20.4	19.7	18.8	19.1	18.7
SET-ASIDE DOLLARS	2.3	2.3	2.9	3.4	4.1	4.8	8.3	10.0	11.7	12.4	14.0
% SET ASIDE TO TOTAL AWARDS	6.0	5.9	6.2	6.2	7.0	7.2	9.5	9.8	9.7	9.9	10.0
% SET ASIDE TO TOTAL SB AWARDS	29.1	28.4	30.5	31.8	33.6	35.3	46.6	49.7	51.3	52.1	53.8

CIVILIAN AGENCIES

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
TOTAL CIVILIAN/AGENCY AWARDS	16.4	15.7	20.8	24.4	23.9	24.4	26.3	29.7	27.2	30.2	40.0
AWARDS TO SMALL BUSINESS	4.8	4.3	6.5	8.5	7.4	7.9	6.8	8.0	5.6	9.1	7.1
PERCENT TO SMALL BUSINESS	29.2	27.5	31.3	34.6	31.0	32.4	25.8	26.7	20.6	30.2	17.8
SET-ASIDE DOLLARS	.88	.89	1.4	1.7	1.7	2.4	2.3	2.7	2.5	3.1	2.7
% SET ASIDE TO TOTAL AWARDS	5.4	5.7	6.7	7.0	7.1	9.8	8.7	9.1	9.2	10.3	6.7
% SET ASIDE TO TOTAL SB AWARDS	18.3	20.7	21.5	20.0	23.0	30.4	33.8	33.7	44.6	34.1	38.0

TOTAL ALL AGENCIES

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
TOTAL FEDERAL PROCUREMENT	54.6	54.7	67.9	78.8	82.4	91.1	113.5	132.2	148.3	155.1	179.6
DOLLAR AWARDS TO SMALL BUSINESS	12.7	12.4	16.0	19.2	19.6	21.5	24.6	28.1	28.4	33.0	33.1
PERCENT TO SMALL BUSINESS	23.2	22.7	23.6	24.4	23.8	23.6	21.6	21.3	19.1	21.2	18.4
SET-ASIDE DOLLARS	3.2	3.2	4.3	5.1	5.8	7.2	10.6	12.7	14.2	15.6	16.7
% SET ASIDE TO TOTAL AWARDS	5.9	5.8	6.3	6.5	7.0	7.9	9.3	9.6	9.6	10.1	9.3
% SET-ASIDE TO TOTAL SB AWARDS	25.0	25.7	26.9	26.6	26.6	33.6	43.1	45.2	50.2	47.3	48.6

Source: Reports from Departments and Agencies and the Federal Procurement Data System

Federal Communications Commission.

Charles Schott,

Chief, Policy and Rules Division, Mass Media Bureau.

[FR Doc. 86-[illegible]]

BILLING CODE 6712-01-M

OFFICE OF MANAGEMENT AND BUDGET

Office of Federal Procurement Policy

48 CFR Parts 6 and 19

Federal Acquisition Regulation; Small Business Set-Aside Determinations (Rule of Two)

AGENCY: Office of Federal Procurement Policy (OFPP), OMB.

ACTION: Proposed rule.

SUMMARY: OFPP is requesting comments on a proposed change to the Federal Acquisition Regulation (FAR) on Small Business Set-Aside Determinations to implement provisions of the Competition in Contracting Act of 1984 (Pub. L. 98-369).

DATE: Comments are due on or before July 21, 1986.

ADDRESS: All interested parties are invited to comment on this proposed regulation change. Comments should be forwarded to William S. Coleman, Jr., Office of Federal Procurement Policy, OMB, 726 Jackson Place, NW., Washington, DC 20503 on or before July 21, 1986. Mr. Coleman may be contacted by phone on (202) 395-3501.

FOR FURTHER INFORMATION CONTACT: William S. Coleman, Jr., Office of Federal Procurement Policy, OMB, 726 Jackson Place, NW., Washington, DC 20503, (202-395-3501).

SUPPLEMENTARY INFORMATION:

A. Background

Prior to the Federal Acquisition Regulation (FAR), the Federal Procurement Regulation (FPR) and the Defense Acquisition Regulation (DAR) contained different criteria for making a total small business set-aside determination.

The DAR provided that if ". . . there is a reasonable expectation that (i) offers will be obtained from *at least two* responsible small business concerns offering the products of different small business concerns and (ii) awards will be made *at reasonable prices* . . ." a set-aside shall be made. (Emphasis added)

The FPR provide that ". . . there must be a reasonable expectation that bids or proposals will be obtained from *a sufficient number of responsible* concerns, organizations, and individuals so that awards will be made *at reasonable prices.*" (Emphasis added)

When the small business section of the FAR was first published for public comment (July 1982), it contained the FPR "sufficient number" standard. Comments received supported a change to the DAR "rule of two" standard. Accordingly, when the final version of the FAR was published on April 1, 1984, it contained the "rule of two" standard.

In July 1984, following the issuance of the FAR, the Competition in Contracting Act of 1984 (CICA) was passed by Congress and signed into law by the President. The CICA contained the following requirement (section 2732):

> ". . . the head of each Executive agency shall, in accordance with applicable laws, Government-wide policies and regulations, and good business practices:
> (1) increase the use of full and open competition in the procurement of property and services by the executive agency by establishing policies, procedures, and practices that assure that the executive agency receives a *sufficient number* of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the *lowest reasonable cost* considering the nature of the property or service procured." (Emphasis added).

The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, *including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984. (Emphasis added.)*

On February 21, 1986, OFPP submitted a proposed regulation to the Department of Defense, General Services Administration, and the National Aeronautics and Space Administration, and directed that it be published in the **Federal Register** for a 30-day comment period. The purpose of the regulation was to replace the "rule of two" criteria now in the FAR with the "sufficient number" criteria specified in the above provision of the Competition in Contracting Act. On March 28, 1986, the Deputy Assistant Secretary of Defense for Procurement advised OFPP that DOD, GSA, and NASA had concluded that ". . . since you have been the proponent of the change, it would be preferable for you to publish the policy directly." Accordingly, pursuant to the authorities granted in section 6 of the Office of Federal Procurement Policy Act, as amended (41 U.S.C. 401, et seq.), notice is hereby given that DOD, GSA, and NASA have failed to issue regulations in a timely manner and it is OFPP's intent to prescribe the following proposed regulation in the FAR due consideration of all comments received in response hereto.

B. Regulatory Flexibility Act

The proposed revision of FAR Parts 6 and 19 is not expected to have a significant impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601, et seq.).

Adoption of the "sufficient number/lower reasonable cost" formula should not reduce the number of small business set-asides. Executive branch agencies will continue to be charged with the obligation to insure a fair proportion of Government contracts be placed with small business concerns, as is required by the Business Act. The regulations will still continue to require that contracting officers review acquisitions to determine if they can be set-aside and will still provide for review of proposed acquisitions by procurement center SBA representatives and Small and Disadvantaged Business Utilization Specialists of the contracting agency.

Contracting officials will still evaluate the nature of the proposed buy to determine if it lends itself to performance by small business. They will also continue to review the purchase history of the item or service to determine if it has previously supplied by small business. They will look at the price history and current market information to determine a reasonable cost range for the item or service. After this review, they will determine if a "sufficient number" of offers can be obtained from small business sources to obtain the "lowest reasonable cost," under a procurement reserved exclusively for competition by small business. In fact, the "sufficient number" standard has been utilized for many years in small business set-asides. Prior to the FAR, all civilian agencies utilized the sufficient number standard. DOD's utilization of the "rule of two" commenced only about 5 years before the FAR.

Establishing that an agency will receive the "lowest reasonable cost" under a small business set-aside requires use of the same good judgment by contracting officials as the current standard of "reasonable price." It should be noted that in many instances, small business is the actual manufacturer of the items or suppliers of the service and, as such, is in a better position to respond than large business. Further, Congress has stated that small business set-asides meet the definition of full and open competition (Pub. L. 98-369, the

Competition in Contracting Act of 1984, and Pub. L. 98-577, the Small Business and Federal Procurement Competition Enhancement Act of 1984). Once it is established that reasonable cost can be obtained under a set-aside procurement, procurement officials are then required to award at the lowest reasonable cost. Only under circumstances where the price from a large business would be substantially lower than that proposed by small business would a set-aside be cancelled. This is the case under current regulations as well.

C. Paperwork Reduction Act

The Paperwork Reduction Act (Pub. L. 96-511) does not apply because the proposed changes to FAR Parts 6 and 19 do not impose any additional reporting or recordkeeping requirements or collection of information form offerors, contractors, or members of the public which require the approval of OMB under 44 U.S.C. 3501, et seq.

List of Subjects in 48 CFR Parts 6 and 19

Government procurement.

It is proposed to amend 48 CFR Parts 6 and 19 as follows:

1. The authority citation for Parts 6 and 19 continues to read as follows:

Authority: 40 U.S.C. 486(c); Chapter 137, 10 U.S.C. and 42 U.S.C. 2453(c).

PART 6—COMPETITION REQUIREMENTS

2. Section 6.101 is amended by adding paragraph (c) to read as follows:

6.101 Policy

* * * * *

(c) 41 U.S.C. 414 requires the establishment of policies, procedures and practices that assure that the executive agency receives a sufficient number of sealed bids or competitive proposals from responsible sources to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost considering the nature of the property or service procured. This requirement applies to all agency procurements, including those made under set-aside programs.

PART 19—SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS CONCERNS

3. Section 19.501 is amended by revising paragraph (g) to read as follows:

19.501 General.

* * * * *

(g) Once a product or service has been acquired successfully by a contracting office on the basis of a small business set-aside, all future requirements of that office for that particular product or service not subject to simplified small purchase procedures shall be acquired by repetitive set-aside if the contracting officer provides a written determination reaffirming that the original basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, will apply to each subsequent procurement in that class.

* * * * *

4. Section 19.502-2 is revised to read as follows:

19.502-2 Total Set-asides.

The entire amount of an individual acquisition or class of acquisitions, including contracts for architect-engineer services, research, development, test and evaluation, maintenance repair, and construction, except small business-small purchase set-aside, shall be set aside for exclusive small business participation if the contracting officer determines that there is a reasonable expectation that full and open competition, consistent with the provisions of 41 U.S.C. 414, will result. The contracting officer's determination must demonstrate that under set-aside conditions, a sufficient number of responsible small business concerns will respond to fulfill the Government's requirements (including performance and delivery schedules) at the lowest reasonable cost, considering the nature of the property or service acquired. Compliance with the presumption of sufficiency will vary, taking into account the size, character and complexity of each procurement and the pool of prospective bidders. Total set-asides shall not be made unless such a reasonable expectation exists. Although past acquisition history or an item or similar items is important, it is not the only factor to be considered in determining whether a reasonable expectation exists. In determining that an entire class of acquisitions may be set aside, the contracting officer shall provide a written determination establishing the basis for concluding that full and open competition, consistent with the provisions of 41 U.S.C. 414, can be achieved on each procurement in that class, evaluating in detail the quality, timeliness and cost factors noted above.

David F. Baker,
Acting Administrator.

Dated: May 15, 1986.

[FR Doc. 86-11534 Filed 5-21-86; 8:45 am]

BILLING CODE [illegible]

INTERSTATE COMMERCE COMMISSION

49 CFR Ch. X

[Ex Parte No. 347 (Sub-2)]

Rate Guidelines, Non-Coal Proceedings

AGENCY: Interstate Commerce Commission.

ACTION: Notice of proposed policy.

SUMMARY: The Commission proposes to adopt maximum rate reasonableness guidelines for captive, non-coal commodities. In addition, the Commission is requesting comments on alternative guidelines for small shippers, including small coal shippers.

DATES: Notices of intent to participate will be due June 2, 1986. A service list will then be prepared and distributed. Comments must be submitted by July 21, 1986. Reply comments will be due 45 days thereafter.

ADDRESS: An original and 15 copies of comments and replies should be sent to: Office of the Secretary, Case Control Branch, Interstate Commerce Commission, Washington, DC 20423.

and served on all parties of record.

FOR FURTHER INFORMATION CONTACT:

Leslie J. Selzer, (202) 275-7827;

or

Thomas J. Stilling, (202) 275-7442.

SUPPLEMENTARY INFORMATION: By decision served September 3, 1985, (50 FR 35562) in Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines, Nationwide, (Coal Rate Guidelines)* the Commission adopted guidelines for determining the reasonableness of captive coal rates. During the pendency of that proceeding the Commission, by and large with the concurrence of the affected parties, has deferred decision on much of its maximum rate docket. A petition to set guidelines for commodities other than coal was likewise dismissed as premature.[1] With the conclusion of the

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[1] Ex Parte No. [illegible], *Petition for Determination of Maximum Reasonableness Guidelines for Non-Coal Commodities*, (not printed) served May 3, [illegible].

ARCHITECT AND ENGINEERING AWARDS FOR CONSTRUCTION 1/
(EXCLUDING NAVAL A&E)
(AMOUNTS IN THOUSANDS)

	TOTAL A & E		LARGE AND SMALL BUSINESS						SET-ASIDES				SMALL DISADVANTAGED							
			LARGE		SMALL		PCT OF SMALL		SET-ASIDES		PCT OF TOTAL		NON-8A		8A		TOTAL SM-DIS		PCT-TOTAL	
	ACTNS	$(000)	ACTNS	$(000)	ACTNS	$(000)	ACTN	AMT	ACTNS	$(000)	ACTN	AMT	ACNS	$(000)	ACNS	$(000)	ACNS	$(000)	ACTN	AMT
ARMY (Excluding Civil Functions)																				
FY 79	1,551	82,133	340	27,577	1,211	54,556	78.1	66.4	42	4,382	2.7	5.3	119	5,649	4	130	123	5,779	7.9	7.0
FY 80	1,275	76,769	284	32,735	991	44,034	77.7	57.4	92	5,016	7.2	6.5	94	3,962	8	209	102	4,171	8.0	5.4
FY 81	1,716	96,517	254	25,630	1,462	70,887	85.2	73.4	663	33,252	38.6	34.5	174	7,162	17	625	191	7,787	11.1	8.1
FY 82	2,216	137,984	230	36,716	1,986	101,268	89.6	73.4	1410	69,872	63.6	50.6	203	8,839	24	474	227	9,313	10.2	6.7
FY 83	1,722	194,451	235	69,832	1,487	124,619	86.4	64.1	1,306	104,753	75.8	53.9	201	14,280	7	1,800	208	16,080	12.1	8.3
FY 84	2,123	205,200	303	58,886	1,820	146,314	85.7	71.3	1,392	106,977	65.6	52.1	228	16,076	11	908	239	16,984	11.3	8.3
FY 85	2,275	243,257	468	100,796	1,807	142,461	79.4	58.5	587	41,138	25.8	16.9	213	16,515	8	464	221	16,979	9.7	7.0
CIVIL FUNCTIONS																				
FY 79	476	47,072	108	29,833	368	17,239	77.3	36.6	7	592	1.5	1.3	25	1,036	-	-	25	1,036	5.3	2.2
FY 80	383	23,260	98	9,671	285	13,589	74.4	58.4	16	1,312	4.2	5.6	32	1,060	4	600	36	1,660	9.4	7.1
FY 81	488	26,982	114	12,106	374	14,876	76.6	55.1	79	3,266	16.2	12.1	38	1,002	7	252	45	1,254	9.2	4.6
FY 82	319	15,295	99	7,348	220	7,947	69.0	52.0	109	3,564	34.2	23.3	47	1,088	-	-	47	1,088	14.7	7.1
FY 83	141	12,675	29	3,725	112	8,950	79.4	70.6	83	5,824	58.9	45.9	15	662	7	309	22	971	15.6	7.7
FY 84	154	10,022	18	1,314	136	8,708	88.3	86.9	117	6,688	76.0	66.7	10	444	4	600	14	1,044	9.1	10.4
FY 85	183	14,789	25	4,477	158	10,312	86.3	69.7	97	6,673	53.0	45.1	6	280	1	100	7	380	3.8	2.6
NAVY																				
FY 79	1,248	61,736	107	7,665	1,141	54,071	91.4	87.6	125	5,258	10.0	8.5	73	2,529	-	-	73	2,529	5.8	4.1
FY 80	1,342	80,123	95	8,563	1,247	71,560	92.9	89.3	575	31,921	42.8	39.8	140	6,420	2	849	142	7,269	10.6	9.1
FY 81	1,664	99,249	143	17,497	1,521	81,752	91.4	82.4	1,229	67,066	73.9	67.6	188	8,720	2	106	190	8,826	11.4	8.9
FY 82	2,234	139,772	148	25,811	2,086	113,961	93.4	81.5	1,903	95,091	85.2	68.0	282	12,051	-	-	282	12,051	12.6	8.6
FY 83	1,884	206,834	241	64,733	1,643	142,101	87.2	68.7	1,472	122,402	78.1	59.2	225	16,446	3	189	228	16,635	12.1	8.0
FY 84	1,816	179,142	203	44,676	1,613	134,466	88.8	75.1	1,242	99,015	68.4	55.3	214	16,716	1	160	215	16,876	11.8	9.4
FY 85	1,994	168,360	306	36,509	1,688	131,851	84.6	78.3	740	61,529	37.1	36.6	297	19,808	2	266	299	20,073	15.0	11.9
AIR FORCE																				
FY 79	130	9,725	19	3,098	111	6,627	85.4	68.1	31	1,634	23.8	16.8	6	136	1	12	7	148	5.4	1.5
FY 80	148	14,052	13	5,639	135	8,413	91.2	59.9	46	2,166	31.1	15.4	16	915	4	266	20	1,181	13.5	8.4
FY 81	222	11,557	22	2,305	200	9,252	90.1	80.1	158	6,464	71.2	55.9	29	1,309	2	43	31	1,352	14.0	11.7
FY 82	519	19,950	24	1,855	495	18,095	95.4	90.7	380	13,597	73.2	68.2	77	3,057	10	215	87	3,272	16.8	16.4
FY 83	247	17,513	13	1,529	234	15,984	94.7	91.3	189	12,770	76.5	72.9	36	2,327	4	266	40	2,593	16.2	14.8
FY 84	234	18,783	18	2,033	216	16,750	92.3	89.2	148	10,757	63.2	57.3	37	2,366	-	-	37	2,366	15.8	12.6
FY 85	358	30,126	78	10,440	280	19,686	78.2	65.3	75	4,032	20.9	13.4	54	4,288	1	48	55	4,336	15.9 15.4	14.4
DLA																				
FY 79	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 80	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 81	1	13	-	-	1	13	100.0	100.0	1	13	100.0	100.0	-	-	-	-	-	-	-	-
FY 82	11	184	-	-	11	184	100.0	100.0	10	167	90.9	90.8	-	-	-	-	-	-	-	-
FY 83	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 84	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 85	1	28	-	-	1	28	100.0	100.0	-	-	-	-	-	-	-	-	-	-	-	-
TOTAL DOD																				
FY 79	3,405	200,666	574	68,173	2,831	132,493	83.1	66.0	205	11,866	6.0	5.9	223	9,350	5	142	228	9,492	6.7	4.7
FY 80	3,148	194,204	490	56,608	2,658	137,596	84.4	70.9	729	40,415	23.2	20.8	282	12,357	18	1,924	300	14,281	9.5	7.4
FY 81	4,091	234,318	533	57,538	3,558	176,780	87.0	75.4	2,130	110,050	52.1	47.0	429	18,193	28	1,025	457	19,218	11.2	8.2
FY 82	5,299	313,815	501	72,730	4,798	241,055	90.5	77.1	3,812	182,291	71.9	58.1	609	25,036	34	688	643	25,724	12.1	8.2
FY 83	3,994	431,473	518	139,819	3,476	291,654	87.0	✓67.6	3,050	245,749	76.4	✓57.0	477	33,716	21	2,563	498	36,279	12.5	8.4
FY 84	4,327	413,147	542	106,909	3,785	306,238	87.5	✓74.1	2,899	223,637	67.0	✓54.1	489	35,602	16	1,668	505	37,270	11.7	9.0
FY 85	4,811	456,560	877	152,222	3,934	304,338	81.7	✓66.6	1,499	103,372	31.1	✓22.6	570	40,891	12	677	582	41,568	12.1	9.1

1/ This table presents all A&E actions (minus 8216 marine A&E) that are for construction (C2 in item 10C) for work performed in the U.S. and its possessions.

read "on", and in the third line after "not" insert "refiled".

4. On the same page, § [illegible], second column, second line, "May 21, 1986" should read "June 20, 1986", and in the eighth line the second "the" should be removed.

BILLING CODE 1505-01-M

SMALL BUSINESS ADMINISTRATION

13 CFR Part 121

Small Business Size Standards; Definition of Small Business for Engineering, Architectural and Surveying Services

AGENCY: Small Business Administration.

ACTION: Final rule.

SUMMARY: SBA is amending its size standard regulations for engineering, architectural, and surveying services to $2.5 million in annual receipts, averaged over the firm's most recent three completed fiscal years, as the appropriate size standard for all three services. This is a decrease from the current size standards of $7.5 million for engineering services and $3.5 for architectural services and surveying services.

This rule does not include the size standards applicable to engineering services for military and aerospace equipment and weapons, for marine engineering or for naval architecture. These services have separate size standards.

EFFECTIVE DATE: August 8, 1986.

FOR FURTHER INFORMATION CONTACT: Norman S. Salenger, Size Standards Staff, Small Business Administration, (202) 653-6373.

SUPPLEMENTARY INFORMATION: On September 16, 1985, SBA published in the **Federal Register** (50 FR 37530) a proposed rule to lower the size standards for engineering, architectural, and surveying services, allowing a 60-day comment period. The proposal was in response to the urging of a number of firms and several industry associations for the SBA to lower the size standards considerably. The proposal informed the public that SBA intended to reduce the size standard for these services to as low as $1.5 million. Upon request, the comment period was extended by 30 days. The comments reflected that the proposed reduction to $1.5 million was inappropriate. SBA received 153 comments from firms in the affected industries and an additional 154 comments from others in the private sector such as associations, firms in other industries, and employees of firms in the industries affected. Comments were also received from federal agencies and several members of Congress. Sixty-two percent of the comments received from firms in the affected industries were in opposition to the proposed reduction to $1.5 million. Federal agencies were split in their acceptance of a $1.5 million size standard. A more modest reduction was suggested by a number of commenting firms as well as by several of the Federal agencies opposed to the $1.5 million size standard.

Considering the arguments presented by those commenting as well as the industry structure, the SBA has decided that a more moderate reduction to $2.5 million is appropriate.

Comments From the Public

On September 16, 1985, after continuous urging by a number of sources including the largest engineering services trade association, SBA published notification of its intent to lower the size standards for engineering, architectural, and surveying services. SBA proposed $1.5 million as the new standard for these services. All three activities share the same Standard Industrial Classification. Including an extension, the comment period was 90 days.

SBA received 153 comments from firms in the subject industries. 57 were in favor of a reduction, 94 were opposed and 2 firms submitted vague comments. Among industry groups, 137 were from consulting engineering firms (81 opposed the proposal), 5 from architectural firms (4 opposed the proposal), and 11 from surveying firms (9 opposed the proposal). Overall, 62 percent of the commenting firms in the affected industries opposed a proposed reduction to $1.5 million. In cases where a firm's comments failed to give sufficient reasons for that firm's position or where the size of the commenting firm could not be determined by SBA, that commentor was contacted, by letter, to obtain additional information; about half replied. The positions, by size of firm in these industries, are summarized in Table 1.

TABLE 1.—COMMENTS BY SIZE OF FIRMS TO THE PROPOSAL OF SEPTEMBER 1985 TO LOWER THE ENGINEERING, ARCHITECTURAL, AND SURVEYING SERVICES SIZE STANDARDS TO $1.5 MILLION

Annual receipts of firm commenting	For the proposal	Against the proposal	Vague
Over $7.5 million	11	3	0
$3.5 to $7.4 million	2	29	1
$1.5 to $3.4 million	0	30	0
Under $1.5 million	39	0	0
Firm size unknown	10	29	1
Totals	57	94	2

More important than a count of those comments for or against the proposal are the various points presented. Firms with annual receipts of under $1.5 million had a strong tendency to support the proposal. These firms pointed out their difficulty in obtaining Federal contracts and attributed this to the preference of procuring agencies for firms above $1.5 million in annual receipts. Firms with annual receipts between $1.5 and $7.5 million, basically, did not want to lose eligibility for set-asides and stressed their dependence upon this benefit.

However, this group often recommended a more moderate reduction than $1.5 million. A number of firms reported their level of Federal contracts. A few of the larger firms now within the size standards received Federal contracts in the range of $600,000 to over $1 million per year. Those firms with receipts of under $1.5 million usually reported receiving no, or very few Federal contracts per year.

Comments From Federal Agencies

The commenting agencies had mixed positions. Three agencies, including the Department of Defense, supported the proposed reduction to $1.5 million. DoD accounts for 90 percent of all procurement to which the subject size standards apply. Five agencies, including the Veterans Administration, had no objection to the proposed $1.5 million size standard. The Veterans Administration is the largest non-defense Federal procurer of these services. Eight agencies opposed the full reduction. However, half of these suggested a reduction of less magnitude.

Industry Structure

Engineering services include numerous separate activities, but approximately 84 percent of the receipts of engineering firms is for design services used in construction. The engineering services industry as a whole, however, is not highly sensitive to Federal procurement activity; less than 6 percent of its receipts come from

Federal contracts. Many engineering firms have in-house capability for architectural services and a lesser number for surveying services. However, most firms engaged primarily in architectural or surveying services specialize only in that discipline and are relatively much smaller in average size than engineering firms. Table II contains the latest available Census data on industry structure.

TABLE II.—ENGINEERING, ARCHITECTURAL AND SURVEYING SERVICES INDUSTRY STRUCTURE IN BRIEF—1982 CENSUS

	Eng. firms	Arch. firms	Surv. firms
Number of Firms Operating Entire Year			
With receipts under $1 million	18,231	11,110	5,937
With receipts $1 to 2.4 million	1,493	687	107
With receipts $2.5 to 4.9 million	530	195	27
With receipts $5.0 to 9.9 million	302	118	8
With receipts $10 million or more	258		
Totals	20,814	12,110	6,079
Average Firm Size in Receipts	$1,282,720	$464,120	$175,222
Percentage of 1982 Industry Receipts			
Firms under $1 million in receipts	15.04	42.90	68.01
Firms $1.0 to 2.4 million in receipts	8.62	18.08	14.30
Firms $2.5 to 4.9 million in receipts	7.21	11.30	8.47
Firms $5.0 to 9.9 million in receipts	7.34	27.50	9.22
Firms with $10 million or more in receipts	61.79		
Total (percent)	100.00	100.00	100.00

Source: U.S. Bureau of the Census, 1982 Census of Service Industries, SC 82-I-1.

Federal Contracting in Recent Years

The unique feature of Federal purchasing of engineering services is that the Federal agencies rate proposals in order of merit. The price and other terms are then negotiated with the highest rated proposal. If agreement is not reached, negotiations are made for the next highest rated proposal. This process continues until the contract is placed.

The Department of Defense accounts for approximately 80 percent of the value of all construction related architectural and engineering services purchased by the Federal Government. Legislation to constrain the Department of Defense from setting aside architecture and engineering service contracts exceeding $85,000 in total value went into effect starting in FY 1985. As a result, the percentage of dollars set aside by DoD dropped from 54.1 percent in FY 1984 to 22.8 percent for FY 1985. However, the small business share of awards dropped only 7 percentage points from 74.1 percent in FY 1984 to 66.6 percent in FY 1985, indicating that small business was successful in obtaining a large share of awards without benefit of set-aside provisions. These data are shown in Table III.

Table III.—Department of Defense Construction Related Architecture and Engineering Awards FY 1984-85

[Dollars in millions]

	FY 1984	1985
All awards	$413	$456
Awards to small business	$306	$304
Percent to small business	74.1	66.6
Value of set asides	$224	$103
Set aside percent—		
of all procurement	54.1	22.8
of small business share	73.0	33.9

Source: Department of Defense.

In non-defense agencies, slightly less than half the value of awards are through set-asides. Small firms receive about 90 percent of the awards of under $100,000. Over 80 percent of all awards are under $100,000 in value. The General Services Administration and the Veterans Administration are the leading procuring agencies for these services.

There are approximately 3,000 Federal awards per year in the subject industries. A relatively small percentage of firms receive more than one award in any year. Where more than one award was received in a year, the recipient usually had annual receipts in excess of $3.5 million. The dollar value of Federal awards to specific contractors with over $7.5 million in annual receipts was several times that to specific contractors with receipts of under $7.5 million. These figures do not include 8(a) program contracts.

The Decision to Set the Size Standard at $2.5 Million

The following factors were taken into consideration in setting the size standards for engineering, architectural, and surveying services at $2.5 million:

1. Based on the 1982 Census of Service Industries, engineering firms with receipts of under $1.0 million accounted for only 15.4 percent of the industry receipts. In general, SBA would prefer a higher level of coverage such as that associated with a size standard of $2.5 million in order to maintain some comparability with the coverage occurring in other service industries.

2. From the comments, and particularly those from Federal agencies, there is the indication that too few Federal contracts would be set-aside at a size standard of $1.5 million. This is due to the perceived absence of firms with sufficient technical capabilities with receipts of $1.5 million or less. At the $2.5 million size standard level there should be a sufficient number of firms with the technical capability to meet Government contracting requirements.

3. The information developed from the comments indicates that the small business share is made up largely of contracts awarded to firms with receipts from $2.5 to $7.5 million. The Department of Defense data show that from FY 1984 to FY 1985, those firms within the size standard were capable of maintaining almost all their share of the architecture and engineering contracts even though the set-aside value dropped to less than half. This indicates that firms between $2.5 and $7.5 million in annual receipts are competitive in the unrestricted market. There would seem to be no reason to continue small business preference for these firms. Therefore, the Agency is setting the size standard to direct assistance to the smaller firms not currently receiving an adequate share of the set-aside contracts.

Compliance With Executive Order 12291, Regulatory Flexibility Act and Paperwork Reduction Act

This final rule defines which firms are eligible to bid on Federal contracts set aside for small business for engineering, architectural, and surveying services where these services are not for military and aerospace equipment and weapons. SBA has determined that this regulation is a major rule as defined by Executive Order 12291 because it is likely to have an annual economic effect of $100 million or more. In FY 1985, the Department of Defense (DoD) set aside $103 million of engineering, architectural, and surveying services contracts and non-defense agencies are estimated to have set aside $32 million of such contracts. Thus, the total amount of set-asides which are likely to be affected by this rule is approximately $135 million, well above the $100 million criterion for a major rule. SBA notes, however, that this rule does not qualify as a major rule under the other two criteria of the Executive Order: it would not be likely to result in a major increase in costs or prices, nor would it be likely to have a significant adverse effect on the United States economy.

SBA certifies that this regulation will not have a significant adverse impact on a substantial number of small entities within the meaning of the Regulatory

Flexibility Act, 5 U.S.C. 601 *et seq.* It may, however, have some negative impact on a few firms which are currently considered small within SBA's size standards, but which are larger in size than the industry average. Therefore, in compliance with the Regulatory Flexibility Act and Executive Order 12291, SBA offers this regulatory flexibility and economic impact analysis.

There are many more firms in the industry than Federal contracts awarded in any year. Thus, most firms do not receive a single Federal contract in any year, but depend on the non-Federal marketplace for their business. Most firms that receive awards in any year receive only one award and that, most often, is less than $100,000 in value. The few firms that receive more than one award in any year are not generally dependent upon Federal contracts for the bulk of their business. Furthermore, most contracts in these industries are not set aside for exclusive small business bidding and would not be affected by this rule. There is no evidence that any firm's loss of eligibility to bid on set-asides would result in its discontinuance in business.

The subject industries are comprised of 39,003 firms, according to the latest Census. Of these, 38,505 are currently eligible under SBA size standards. Under a size standard of $2.5 million, 37,574 firms will retain eligibility and 931 firms will lose eligibility. Most losing eligibility are not in the Federal marketplace; thus, this rule affects only a minority of firms who use Federal contracts to supplement their sales. Firms losing eligibility to bid on contracts set aside for small business will still be able to bid on the bulk of Federal contracts which are not presently set aside. Those losing eligibility for set-asides are the larger of the now eligible firms and are generally in a stronger economic position than firms in the sector retaining eligibility.

This regulation is likely to have a favorable impact on small entities with receipts below the reduced size standard. Federal contracts set aside for small business should be directed to those firms with a greater need to participate in the Federal marketplace. Thus, those businesses which are truly small will benefit the most from this rule. The rule, by itself, imposes no costs on the Government, nor on firms seeking Government procurements. Consequently, the smaller firms will enjoy the net benefits of the rule.

These size standards will also be used to determine a firm's eligibility to receive an SBA business loan. Almost all SBA loans are made to the smallest of firms, often those just starting in business or in the early stages of growth. Thus, this rule will have virtually no impact on engineering, architectural or surveying firms at a size level of $2.5 million or more in annual receipts for purposes of financial assistance.

The rule defines the maximum size a firm may be to receive SBA assistance and to bid on contracts set aside by all Federal agencies for small firms for the subject services. The legal bases for this final rule are sections 3(a) and 5(b)(6) of the Small Business Act, (15 U.S.C. 632(a) and 634(b)(6)). There are no Federal rules which would duplicate, overlap or conflict with this final rule.

SBA certifies that this regulation contains no reporting or recordkeeping requirements which are subject to the Paperwork Reduction Act, 44 U.S.C., Chapter 35.

List of Subjects in 13 CFR Part 121

Administrative practice and procedure, Government procurement, Government property, Grant Programs-business, Loan programs-business, Reporting and recordkeeping requirements, Small business.

PART 121—[AMENDED]

Accordingly, Part 121 of 13 CFR is amended as follows:

1. The authority citation for Part 121 of 13 CFR continues to read as follows:

Authority: Secs. 3(a) and 5(b)(6) of the Small Business Act, as amended, 15 U.S.C. 632(a) and 634(b)(6).

§ 121.2 [Amended]

2. The table in § 121.2(c)(2), for Major Group 89—Miscellaneous Services, item 8911, is revised to read as follows:

SIC	Description	Size Standards in number of employees, or millions of dollars
	Maj. Group 89—Miscellaneous Services	
8911	Engineering Services, Except Military and Aerospace Equipment, and Except for Military Weapons	$8.5
8911	Engineering Services for Military and Aerospace Equipment and for Military Weapons (Except Marine Engineering)	13.5
8911	Marine Engineering and Naval Architecture	9.0
8911	Architectural Services (Except Naval) and Surveying Services	2.5

* * * * *

Dated: June 3, 1986.

Charles L. Heatherly,

Acting Administrator.

[FR Doc. 86-12858 Filed 6-6-86; 8:45 am]

BILLING CODE 8025-01-M

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 21

[Docket No. NM-19; Special Conditions No. 25-ANM-10]

Special Conditions: American Aviation Industries Reengined JetStar Model 1329 Series Airplane

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final special conditions.

SUMMARY: These special conditions are issued pursuant to §§ 21.16 and 21.101 of the Federal Aviation Regulations (FAR) to American Aviation Industries (AAI) for a Supplemental Type Certificate (STC) for the AAI reengined JetStar Model 1329 series airplane. The reengined JetStar airplane will have novel or unusual design features associated with an automatic takeoff thrust control system (ATTCS) for which the applicable airworthiness regulations do not contain adequate or appropriate safety standards. The ATTCS will allow the airplane to take off with less than maximum takeoff thrust approved for the airplane; and, if an engine fails, the system will automatically provide maximum takeoff thrust on the operating engine. These special conditions contain safety standards which the Administrator finds necessary to establish a level of safety equivalent to that provided by the regulations applicable to the AAI reengined JetStar airplane because of the novel or unusual features.

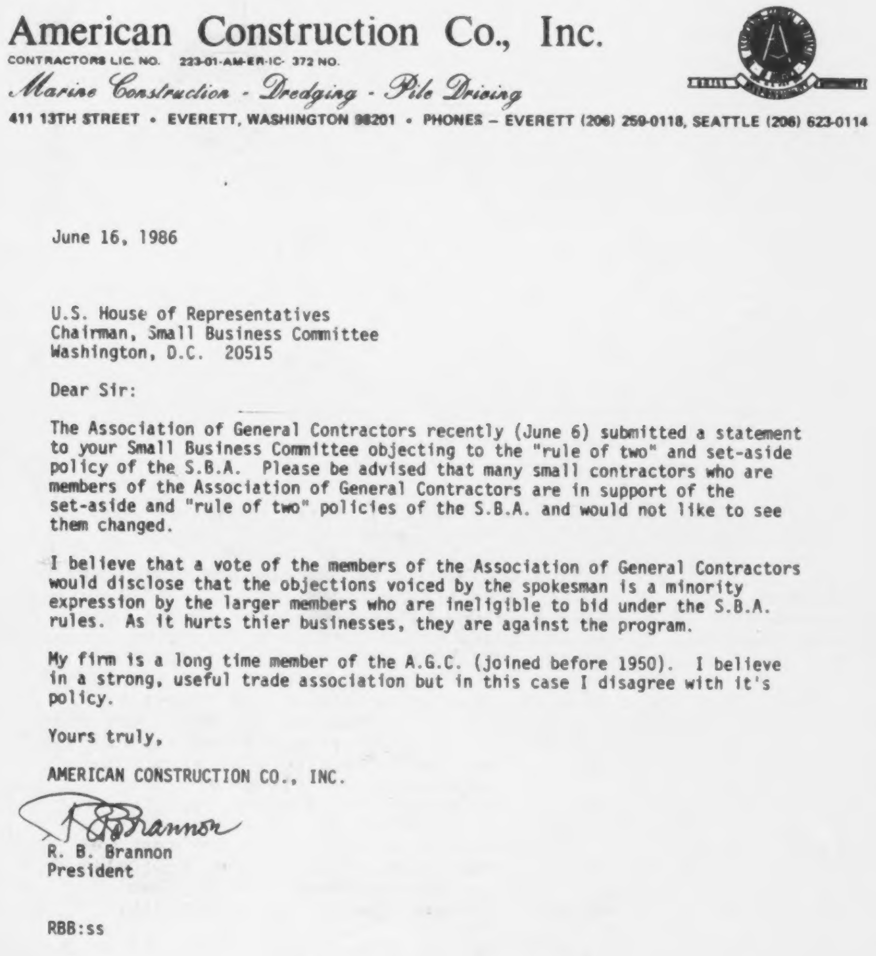
EFFECTIVE DATE: July 9, 1986.

FOR FURTHER INFORMATION CONTACT: James Walker, Policy and Procedures Branch, Transport Standards Staff, ANM-110, FAA, Northwest Mountain Region, 17900 Pacific Highway South, C-68966, Seattle, Washington 98168; telephone (206) 431-2116.

DoD Construction
FY 1985
(dollars in billions)

Total	Small Business Share	Small Business % of Total	Set-Asides	Set-Asides as % of Total	Set-Asides as % of Small Business Share
$7.886	$5.755	72.9%	$4.515	57.2%	78%

D.—Additional Comments From the American Construction Co., Inc.



American Construction Co., Inc.
CONTRACTORS LIC. NO. 223-01-AM-ER-IC- 372 NO.
Marine Construction - Dredging - Pile Driving
411 13TH STREET • EVERETT, WASHINGTON 98201 • PHONES – EVERETT (206) 259-0118, SEATTLE (206) 623-0114

June 16, 1986

U.S. House of Representatives
Chairman, Small Business Committee
Washington, D.C. 20515

Dear Sir:

The Association of General Contractors recently (June 6) submitted a statement to your Small Business Committee objecting to the "rule of two" and set-aside policy of the S.B.A. Please be advised that many small contractors who are members of the Association of General Contractors are in support of the set-aside and "rule of two" policies of the S.B.A. and would not like to see them changed.

I believe that a vote of the members of the Association of General Contractors would disclose that the objections voiced by the spokesman is a minority expression by the larger members who are ineligible to bid under the S.B.A. rules. As it hurts thier businesses, they are against the program.

My firm is a long time member of the A.G.C. (joined before 1950). I believe in a strong, useful trade association but in this case I disagree with it's policy.

Yours truly,

AMERICAN CONSTRUCTION CO., INC.

R B Brannon
R. B. Brannon
President

RBB:ss

E.—PREPARED STATEMENT OF NATIONAL TOOLING & MACHINING ASSOCIATION

JUN 16 1986

NATIONAL TOOLING &
MACHINING ASSOCIATION

9300 LIVINGSTON ROAD, FT. WASHINGTON, MD 20744
301/248-6200

June 11, 1986

The Honorable Parren J. Mitchell
Chairman
House Small Business Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Mitchell:

We are submitting these comments for the record of your June 5 Committee hearing on the Rule of Two.

The National Tooling and Machining Association represents the tool, die and precision machining industry. Our industry is composed of 14,000 plants, almost all of which are small business concerns. These companies build special tools, dies, jigs, fixtures, molds, gauges, special machines (automation, robotics, and production lines) and precisioned machined parts or components. They use a wide spectrum of equipment and processes, including most machine tools from the simplest lathe to the most complex computer aided design and computer aided manufacturing systems. They commonly achieve tolerances to one ten-thousandth of an inch or less. These companies serve virtually every manufacturing industry in the country, from automotive to aerospace. Their customary means of doing commercial business is to provide sealed competitive bids from which the customer will generally select the lowest bid. This is also typically the practice of major DoD prime contractors, some of whom subcontract up to 80% of their spare parts to our members.

We are very supportive of the Rule of Two. The Rule of Two exception has sound rationale behind it, including the maintaining and expanding of our defense industrial base.

Much of what our members are allowed to bid on are small business set-asides. Interestingly, a significant portion of those contracts are let through formally advertised sealed bids. Also, in many of those cases, the procurement had previously been made through much more costly sole source procurements, through large prime contractors. As a result, the use of the Rule of Two in spare parts procurement has led to more rather than less competition.

For that reason we were surprised to learn that the application of the Rule of Two is claimed by the Committee on Federal

The Honorable Parren J. Mitchell
June 11, 1986
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Procurement of Architectural/Engineering Services to have the opposite effect on architectural, engineering and surveying services. It appears that there is either a size standard problem in that industry, or that the Defense Department is somehow not allocating set-asides proportionately among various industries.

Perhaps the best solution would be for SBA to alter the size standard to a number judged most appropriate by COFPAES members. Maybe the easiest solution would be for DoD to reduce the number of small business set-asides in the architectural/engineering area while increasing them by the same amount in the purchase of military spare parts. Without altering the total number of set-asides, the problem of too little competition in the procurement of architectural/engineering services and not enough opportunities for small business to compete in spare parts procurements could be addressed simultaneously. We would be happy to accept as many spare parts set-asides as COFPAES would be willing to spare (no pun intended).

It would also make sense from another standpoint. The use of open competition in our industry, which is a result of the Rule of Two/Set-Aside program, makes sense. All bidders are bidding to the exact same specifications so open competition with selection of the lowest priced responsible bidder makes sense.

On the other hand, there are no doubt frequently subjective criteria involved in the selection of architectural and engineering services. For this reason, the argument put forth by COFPAES has merit. This also argues in favor of shifting the set-asides from architectural/engineering services to the spare parts area.

We would be happy to work with you and your staff, as well as COFPAES members in seeking the best and/or easiest solution to the problem.

Cordially,

Bruce N Hahn

Bruce N. Hahn
Manager, Government Affairs

BNH/mw

cc: William G. Wallace, Jr., COFPAES Chairman
John C. Uehlinger, Exec. Dir., American Congress on Surveying & Mapping
James K. Coyne, Exec. V.P., American Consulting Engineers Council
Louis Marines, CEO, American Institute of Architects
Dr. Edward O. Pfrang, Exec. Dir., American Society of Civil Engineers
Donald G. Weinert, Exec. Dir., Nat'l Soc. of Professional Engineers
Daniel J. Hanson, Sr., ARTBA Planning & Design Division
Joe Wright, OFPP
Mike Horowitz, OFPP
Owen Bernhaum, OFPP
William Coleman, OFPP

F.—Resolutions of the Procurement Committee of the Rye, New York Delegation, The White House Conference on Small Business

Jules W. Wertheimer
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June 4, 1986

THE FOLLOWING ARE THE RESOLUTIONS OF THE PROCUREMENT COMMITTEE OF THE RYE, NEW YORK DELEGATION, THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS:

1. A clause should be included in all Federal Procurement Contracts mandating payment by the Prime Contractor of all Sub-Contractor invoices within 30 days of receipt of payment by the Prime Contractor from the Government.

2. That Small Business Set-Asides be continued, and that the "Rule Of 2" (i.e. a contract will be set-aside for exclusive Small Business participation if the Contracting Officer can expect reasonable Offers from 2 or more responsible Small Business Concerns) be retained as the Criteria therefor.

3. That entities which are either tax supported or tax exempt be reasonably restrained from competing with Small Business in bidding on Government Procurements.

Note:
A. The same or similar recommendations were chosen by the Procurement Issue Forum at the Syracuse Conference on May 22.

B. A similar recommendation to #3 was chosen by the Economic Policy Issue Forum at Syracuse.

Respectfully submitted,

Jules W. Wertheimer

Jules W. Wertheimer
Chairman, Procurement Committtee

G.—PREPARED STATEMENT OF ASSOCIATED BUILDERS AND CONTRACTORS, INC.

Associated Builders and Contractors appreciates the opportunity to express its views on the proposed Office of Management and Budget change to the "Rule of Two" for the Committee's record.

ABC represents 19,000 member companies, 90% of which would be defined as small businesses under current Small Business Administration size standards. Our general contractors, subcontractors, material suppliers and associates employ more than one million workers in the open shop segment of the construction industry which now performs 70% of all work across the nation. The Association promotes the Merit Shop concept of construction which means that a contract should be awarded to the lowest most responsible bidder under fair and open competition. In accordance with our Merit Shop philosophy, ABC supports the proposed OMB change to the Federal Acquisition Regulations (FAR) from the "Rule of Two" standard on Small Business Set-aside Determinations to the "Sufficient Number/Lowest Reasonable Cost" standard. Use of the "Rule of Two" standard has been anti-competitive in the construction industry and has increased the cost of public construction. We view the proposed change as a positive step in the direction of expanding competition to all qualified firms for procurement contracts.

The existing standard (Rule of Two) was incorporated in part 19.502.2 of the Federal Acquisition Regulations (FAR) in 1984 without the benefit of public comments. This standard for government procurement prompted considerable ABC concern. When the Office of Federal Procurement Policy (OFPP) subsequently requested comments on the "rule of two", we submitted our views against the use of this standard of competitiveness. Much controversy surrounded the "rule of two" standard and when the public comments were published, it was found that out of the total number of public comments submitted, 65 percent opposed it. ABC strongly supports the current FAR change to the "Sufficient Number/Lowest Reasonable Cost" standard being proposed by OFPP and urges its adoption as a final rule.

Negative Impact of the "Rule of Two" on the Construction Industry

The "rule of two" states that a contracting officer shall set aside exclusively for small business any contract for which there is a reasonable expectation that two or more small businesses will submit bids at a reasonable price. ABC believes this standard of competitiveness is not in the best interest of the construction industry. This industry is composed of a large number of small firms who by their nature are highly competitive. The long-standing competitive bid process exemplified by the construction industry assures that firms compete on an equal basis in the free enterprise system. This process works well and promotes competitiveness and in turn, cost-effective construction. Small construction firms usually compete with their peers because it would not be economical for large firms to bid on work more efficiently handled by the small firms. To do so would drain financial and personnel resources large firms need to bid on contracts more suitable to their greater capabilities and requirements.

The existing standard is anti-competitive because it does not allow bids and proposals from all qualified bidders. The current SBA size standards for construction are so high ($7 million for specialty contractors, $17 million for general contractors) that they cover about 90% of our member companies. Size standards so unrealistically high, coupled with the "rule of two," exclude certain segments of the construction industry from effectively competing with companies of equal size while at the same time restricting others from bidding on small business government contracts.

Since offers are generally received from 10 to 12 firms in construction procurement at all times, this means that exclusive small business set-asides frequently occur on a repetitive basis with the "rule of two." Companies that do not meet the SBA size standards are therefore denied the opportunity to bid even though they are qualified and may perform the work at a lower price. The current standard also works against the truly small construction firm that must compete against firms at the high end of the SBA size standard. When lowest price is not a primary factor, as in the private sector, it is difficult for the small firm to bid competitively for federal contracts with the "large" small firms.

We acknowledge and appreciate the efforts of this Committee to bring about more realistic size standards as purported in H.R. 1178, a bill to provide for equity in the establishment of small business size standards. High SBA size standards are a matter of concern to ABC, however, they are only part of the problem we encounter with the "rule of two."

Increased costs to the government occur when competition is restricted with the current standard simply because it does not use the lowest reasonable cost formula. We believe the government should have an open procurement process so that procuring agencies will receive goods and services at the lowest possible overall cost. By encouraging all potential contractors to compete for awards, cost-effective procurements will result. Many of our members benefit from preferential treatment, however, we do not feel that the additional costs associated with this type of procurement practice are a justifiable use of tax revenues.

In particular, ABC believes that the "rule of two" is inappropriate for the construction industry. A competitive bid process based on lowest price and ability to perform assures that all firms can effectively compete for and obtain government construction contracts without use of the "rule of two." Entry into the industry is relatively easy and requires little start-up capital. Since there are relatively few barriers to entering this business, new small firms are constantly emerging which assures competition. Construction firms compete for contracts on the basis of price and ability to perform work. The "rule of two" restricts competition in an industry that revolves around the competitive bid process.

"Rule of Two" Contrary to Intent of Competition in Contracting Act of 1984

In 1984, Congress passed the Competition in Contracting Act which requires, to the maximum practicable extent, the award of contracts through full and open competition. CICA requires that contracting officers set-aside procurements only after determining that there is a reasonable expectation that "full and open competition" will result. In making that determination, contracting officers must demonstrate that a "sufficient number of responsible small business concerns will respond ... at the lowest reasonable cost considering the nature of the property or service procured." The explanatory statement of the managers of the Conference Report on this amendment stated that:

> "This requirement applies to all agency procurements, including those made under set-aside programs." H.R. Rep. No. 98-861, 98th Cong. 2d Sess. 1984 (Emphasis Added).

It is clear that in passing CICA, Congress intended to maximize full and open competition to meet the government's procurement needs and restrain costs. The "rule of two" standard, however, requires restricted competition when a contracting officer merely expects that two small businesses will have an interest in bidding on a contract with secondary regard for the final contract cost. Currently, once a product or service is procured under a set-aside, all future procurements of the same type are automatically set-aside without the benefit of a reexamination or reaffirmation of the reasons for setting aside the class of product or service. This restriction is clearly contrary to the full and open competition mandate of the Competition in Contracting Act.

ABC believes that use of the sufficient number/lowest reasonable cost formula proposed by OMB would still assure that small business receives a fair proportion of government contracts without closing the federal market to all qualified firms. It would also prevent contracting officers from automatically setting aside procurements on a repetitive basis. This would be helpful to the construction industry which has been heavily relied upon by federal construction procuring agencies, in particular the Department of Defense, to meet their small business procurement goals. The lowest reasonable cost formula incorporated in the proposed OMB change is most favorably looked upon by the construction industry. With this provision, for a contracting officer to set a procurement aside, he/she must reasonably foresee that competition conducted solely among small businesses is likely to result in the lowest reasonable cost. This is a more cost-effective way to meet government requirements than the rule of two standard.

Conclusion

As previously mentioned, OFPP received many public comments in opposition to the "rule of two" at the end of 1984. It is time that action is taken to amend the Federal Acquisition Regulations with the "sufficient number/lowest reasonable cost" standard to bring it in line with original congressional intent. This change is long overdue since CICA became effective in April, 1985. ABC commends OFPP for addressing the "rule of two" issue and providing leadership in resolving the differences on procurement policy by bringing the FAR into conformity with CICA. We will submit comments on OFPP's proposal to change the "rule of two" as part of the rulemaking process.

ABC favors the elimination of the "rule of two" in federal construction procurement since it is detrimental to competition in the construction industry. Since this proposed OMB change would expand competition in construction procurement and award contracts for the lowest reasonable cost, we strongly urge adoption of the FAR change as a final rule. Additionally, we recommend that the committee review the necessity for small business set-asides in federal construction procurement. Construction is a highly competitive industry and ABC believes the need for small-business set-asides is not justified.

H.—Prepared Statement of American Consulting Engineers Council

American Consulting Engineers Council
1015 Fifteenth Street, N.W., Washington, D.C. 20005 202-347-7474

June 18, 1986

The Honorable Parren J. Mitchell
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

On behalf of the American Consulting Engineers Council (ACEC), the association representing some 4,600 private practice consulting engineer firms with approximately 130,000 employees who are responsible for the design of hundreds of millions of dollars in private and public construction, I want to state for the record our strong support for the recently proposed changes to the so-called "Rule of Two," FAR provision 19.502-2.

The private engineering sector has a high percentage of small businesses. Even under the Small Business Administration's new size standard more than 90% of our members are classified as small businesses. The "Rule of Two" has resulted in many federal agencies setting aside 100 percent of their design and other engineering service contracts to offset their failure to create opportunities for small business in other procurements. This is unfair, as well as being anticompetitive.

Moreover, the "Rule of Two" does particular violence to the spirit and intent of the federally mandated qualifications-based selection procedures for design professionals (P.L. 92-582), in that it introduces size of firm as a prerequisite to participation, size of firm has never been defined as criterion for qualifications and competence.

ACEC believes that the proposed changes will assure small businesses obtain a fair proportion of federal contracts, without closing the market to all qualified firms. In fact small businesses participated under a "sufficient number" test as late as April 1984, and even today successfully compete in the open market for jobs with the Department of Defense under the $85,000 threshold method.

The proposed changes merely recognize the diverse characteristics of the various industries doing business with the federal government and the need for flexibility to deal with those industries.

"Serving the Business and Professional Interests of American Consulting Engineers Worldwide"

Current Regulation

As noted, the Office of Federal Procurement Policy (OFPP) issued a notice of proposed rule change to the Federal Acquisition Regulation (FAR) section 19.502-2. [51 Fed.Reg. 16810 (May 22, 1986)]. Pursuant to this section, federal agencies must currently set-aside contracts for small businesses "if the contracting officer determines that there is a reasonable expectation [that] at least two responsible small business concerns" can do the work. (Emphasis added).

Those supporting the current procedure have been referring to the rule as the "Rule of Two or More," implying some measure of flexibility in the present regulation. However, there is no such language and thus no such flexibility. The rule is applied mechanically by federal agencies thereby prompting the need for the proposed OFPP changes.

Discussion

In accordance with OFPP's recommended changes to the "Rule of Two," the following modifications to the set-aside procedure would occur:

(1) Contracting officers would be required to reaffirm the basis for setting aside procurements of a "repetitive set-aside" class. Presently, no such requirement is employed.

(2) Contracting officers would be required to set-aside procurements only after determining that there is a reasonable expectation that "full and open competition" will result. In making that determination, contracting officers must demonstrate that a "sufficient number of responsible small business concerns will respond . . . at the lowest reasonable cost, . . . taking into account the size, character and complexity of each procurement and the pool of prosective" firms available.

OFPP cites the Competition in Contracting Act of 1984 (CICA), section 2733, as the basis for the above described changes. The section requires that "full and open competition" in the procurement of goods and services be achieved "by establishing policies . . . that assure . . . executive agenc[ies] receive a sufficient number" of responses to bids or proposals.

Some Members of Congress have questioned whether OFPP has interpreted the CICA requirements correctly. In response, OFPP has noted that:

> Since the Competition in Contracting Act required the receipt of a "sufficient number of sealed bids or competitive proposals . . . [to achieve] the lowest reasonable cost . . ." as a standard of competition for all procurements ". . . including those made under set-aside programs," it follows that, when making the original determination to set-aside a particular procurement for small business, the contracting officer must have a reasonable expectation that there will be a _sufficient number_ of small business bids or proposals to fulfill the Government's requirements at the _lowest reasonable cost_. (Emphasis in original).

Moreover, the OFPP proposed rule change is in response to the public input received as a result of an open comment period occasioned by the _Federal Register_ notice of October 12, 1984. Arguably, the proposal is also in accordance with the OFPP Act Amendments of 1983, in which OFPP is authorized "to prescribe Government-wide regulations, procedures and forms in a timely manner" when conflicts exist in procurement policy. 41 U.S.C. 405(c). Finally, none of the FAR Council agencies question OFPP's authority to issue a government-wide procurement rule.

Regardless of the interpretation of CICA or any other statutory authority for OFPP's actions, the question still to be answered is whether the suggested modifications to the "Rule of Two" are beneficial.

Potential Benefits

(1) The proposed changes will assist in preventing some contracting officers from looking good on paper in a few areas by setting aside nearly 100% of the contracts in some industry groups, such as the design industry, to offset the lack of set-asides in other industry groups.

(2) The proposed changes recognize that certain industries may have unique characteristics in which mechanical use of the "Rule of Two" is inadequate and unfair. Thus, under the

proposed changes flexibility is introduced whereby an industry with a high degree of small business participation can use a different threshold to determine what a "sufficient number" is for purposes of triggering set-aside procedures. That is not to say, that "two" responsive small business firms could not continue to be the number applied to trigger the set-aside procedures in industries with a lower degree of small business participation.

(3) The proposed changes will improve the opportunity for open and full competition by taking into the consideration the "size, character and complexity of each procurement" before mechanically setting aside work as done under the current "Rule of Two" procedures. Hopefully this would be accompanied by cost savings arising from matching projects to firm capacity.

(4) The proposed changes properly require the contracting officer, who is responsible for the quality of the goods and services purchased, to decide in accordance with the guidelines provided in the proposed language, whether a given contract should be set-aside.

(5) The proposed changes provide elements, such as the number of available firms, the character and complexity of a project as well as the cost of the service or goods, by which to determine whether a contract is properly set-aside. Currently, there is virtually no accountability or recourse to challenge very "subjective" decisions affecting whether certain contracts are set-aside.

(6) By modifying the "Rule of Two's" set-aside procedures, the proposed changes could play an important role in reducing resistance to revisions to small business size standards. In certain industries proposed size standard changes have been opposed due in part to the fear that they will result in firms being "closed-out" of the federal market when coupled with the anomaly created by the "Rule of Two" practice of 100% set-asides.

For example, the design industry recently had its size standard reduced to $2.5 million annual receipts from $7.5 million for engineering services and $3.5 million for architectural and surveying services. [51 Fed.Reg. 20795 (June 9, 1986)]. As a practical consequence of this change, any firm no longer falling within the size standard is effectively eliminated from the federal market.

Conclusion

The proposed modifications to the "Rule of Two" will not result in the end of small business participation in the federal market. The two are not synonymous. Indeed, the use of a "sufficient" number test to determine whether to set-aside a contract was commonplace among civilian agencies until April 1984. Even now, the "Rule of Two" is not followed by the Department of Defense for setting aside design contracts for military projects. Notwithstanding the use of these different methods, small business participation has continued and even flourished without closing the federal market to all firms.

For the foregoing reasons, ACEC strongly supports the changes proposed by OFPP. The suggested modifications will improve the equity and fairness of setting aside federal contracts, while at the same time ensuring fuller and more open competition for federal projects.

Sincerely,

Laurence Bory

Laurence D. Bory
Managing Director
Governmental and
International Services

LDB:jq